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(P.52)

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WHY TOYOTA IS SO
AFRAID OF BEING NO. 1 (P.42)

WHAT CARL ICAHN IS
TARGETING NEXT (P.68)

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The Business Week

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A Conversation with Slim

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Airbus Revs the Engines

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Economics

Business Outlook

n Cooper says the U.S. cannot count
foreign financing forever. As the
llar weakens and other investments
ekon, a shakeout looms

BusinessWeek (ISSN 0007-7135) Issue number 4024, published
ly, except for one week in January, July and August, by The
raw-Hill Companies, Inc. Executive, Editorial, Circulation, and
rtising Offices: 1221 Avenue of the Americas, New York, N.Y.
10. Periodicals postage paid at New York, N.Y. and at additional
ing offices. Canada Post Publication Mail Agreement Number
12501. Return undeliverable Canadian addresses to: DPGM Ltd.,
26 Bath Road, Mississauga, ON L4T 1L2. Email: bwkcustserv@
ulfillment.com

Master: Send address changes to BusinessWeek, P.O. Box 8418,
Oak, IA, 51591-1418

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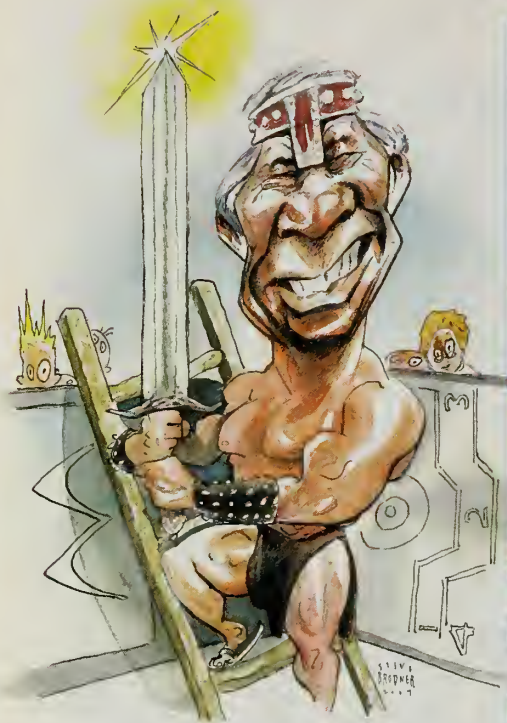
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Innovation for innovation's sake means just more sizzle, not a juicier steak

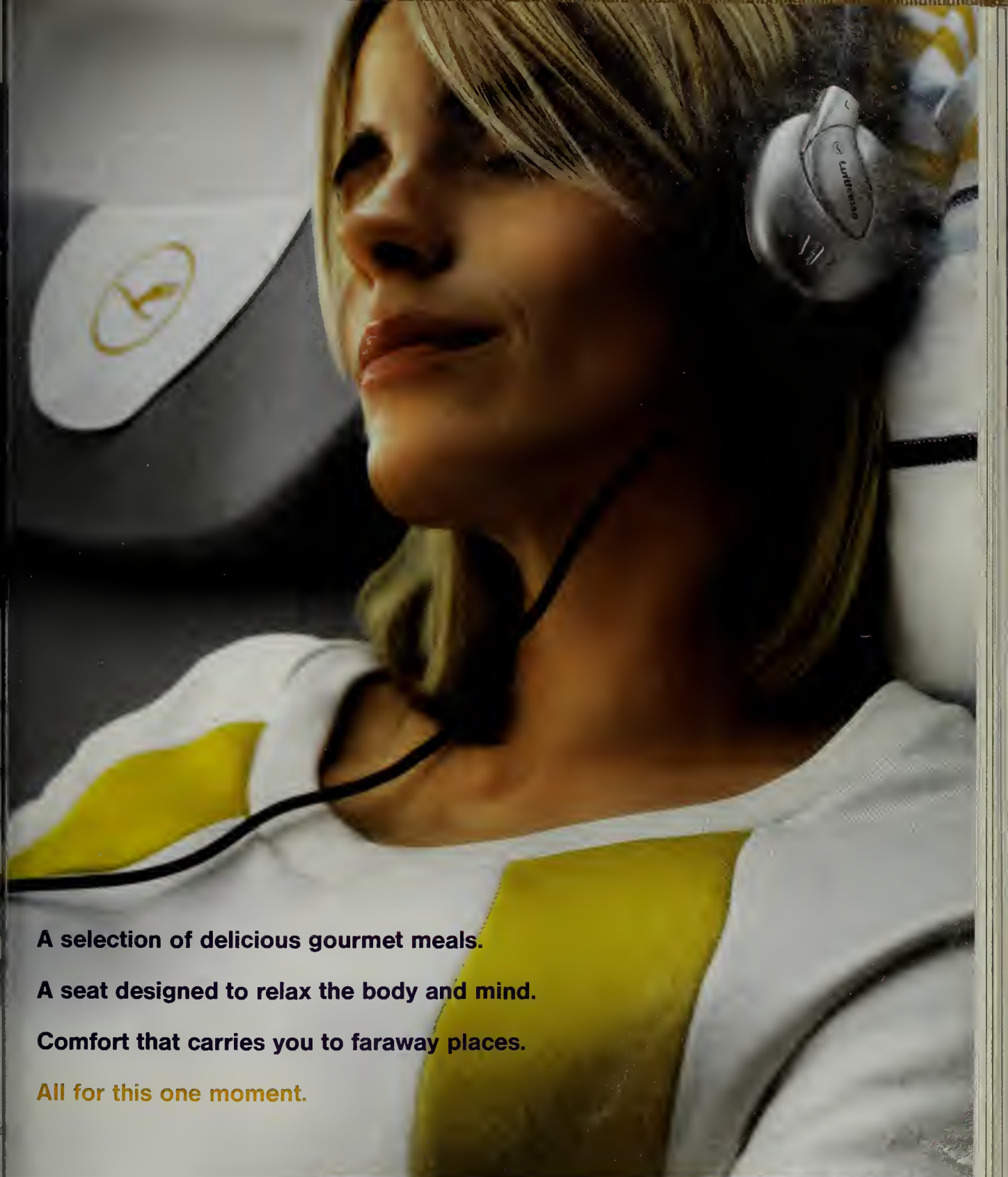
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When it came to our tasting of "white goods," the superpremiums ruled the day. Here, our top three in each category, plus our tasters' comments:

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The Virtual Workforce

Working from home has long been seen as a perk for employees who want to better balance their work and personal lives. It also makes good business sense: IBM, for example, saves \$100 million a year by allowing 42% of its employees to work from home, on the road, or at a client location. BusinessWeek.com's **CEO Guide to Technology** looks at how companies including Microsoft, Sun Microsystems, and Ernst & Young are equipping the new virtual workforce with the tools they need to be productive from nearly anywhere. Our slide show features **all the gadgets** one road warrior uses to stay connected and productive. We also explore the challenges virtual workers face, such as feelings of isolation. Then read about how companies like support.com are lending virtual workers a hand **when technology fails** and there's no help desk to call. Finally, Karen Sobel Lojeski, CEO of Virtual Distance International, talks about the challenges of managing a virtual workforce and where many companies go wrong. Go to www.businessweek.com/technology/ceo_guide for all this and more.

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Brain power

A smiling woman with dark hair is in the foreground, looking towards the camera. In the background, a large white wind turbine is visible against a blue sky with some clouds. The overall image has a blue and white color scheme.

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"We're not terribly optimistic."

—Home Depot CEO Frank Blake in a Feb. 20 conference call with analysts, reacting to the company's 28% profit drop in the fourth quarter of 2006. Blake acknowledged that housing's decline may continue to hurt the business.

EDITED BY DEBORAH STEAD

CEO PAY

Attack of the Shareholders

POLITICAL CHANGE IN

Washington and the public debate on CEO pay are giving the shareholder rights movement a mighty tailwind—momentum that's being sensed in Europe, too.

At home, as House Financial Services Committee Chairman Barney Frank (D-Mass.) prepares to hold hearings on executive compensation, a coterie of corporate giants sat down with pension fund activists pushing for an advisory role on pay. The Feb. 9 meeting, held at TIAA-CREF's New York office, was the brainchild of Pfizer Corporate Secretary Peggy Bran; Richard Ferlauto, director of pension policy at the American Federation of State, County & Municipal Employees; and Anthony Smith, director of socially responsible investment at Walden Asset Management.

Also at the table: Intel, Lehman Plough, JPMorgan Chase, AIG, and other blue chips. The agenda: to draft guidelines on how to give shareholders an advisory vote on pay, an effort business hopes will help it avoid legislation or regulation. (Frank's office has taken note of the meeting.) Around the same time, four big global investors in U.S. stocks were flexing their collective muscle. Norway's Norges Bank Investment Management, Hermes Pension Management of Britain, and Dutch funds ABP and PGGM, with combined assets of \$800 billion, have begun lobbying the SEC for more input in electing directors and an advisory vote on pay. (British and other EU shareholders play such roles.) Former SEC Chairman Arthur Levitt is informally advising the group, and last year hired a veteran U.S. hand as



its CEO—Mark Anson, former CIO of CalPERS, who met with SEC Chairman Christopher Cox on Feb. 7. "With all the capital we're investing in the U.S. from Europe, we should have a chance to weigh in," says Anson.

Some U.S. business leaders think otherwise. "European pensions should no more impose proxy access requirements on American companies than we should force Sarbanes-Oxley on European ones," says John Berla, director of the Center for Entrepreneurship at the Competitive Enterprise Institute, a free-market think tank. Maybe, says Norges' Knut Kjaer. On the other hand, "we are quite free to move our assets." —Lorraine Woellert and Eamon Javers

ON THE JOB

YESTERDAY'S PRINCESSES

Asked to name their dream job, nearly a quarter of U.S. workers in a recent survey pointed to the Oval Office. Queried about their childhood aspirations, however, they recalled a slew of non-Presidential fantasies as well. Here, a look at the youthful ambitions of adults in specific occupations.

—Lindsey Gerdes

TOP CHILDHOOD DREAM JOB, BY CURRENT PROFESSION:



Administrative professionals:
Princess (33%)



Lawyers/Judges:
U.S. President (59%)



Executives:
Firefighter (29%)

Firefighters:
Firefighter (41%)

Data: Harris Interactive 2006 online survey of 6,169 full-time U.S. workers, on behalf of CareerBuilder.com

E-GIVING

CHARITY BEGINS... ONLINE

At many large corporations, a full-time philanthropy staff selects charities to support. For small companies lacking a strategic philanthropic mission, Gratus Capital Management in Atlanta has created CompanyGivingTest.com. The site uses an online questionnaire to help employers find charities from a pool of about 80



nonprofits that Gratus has vetted for soundness.

Employers (or employees) taking the survey agree or disagree with 55 statements to pinpoint causes that fit a company's values or employees' preferences. (Sample: "The problem of homelessness is perhaps the greatest tragedy of our society.") Gratus uses the results to recommend three to five charities.

The month-old service, which starts at \$2,500 for 1 to 50 test takers, has been used by the 15 employees at Access Worldwide in Atlanta, a mailing services operation that paid about \$1,000 for a customized questionnaire. It was "a great tool," says Access CEO Adam Langston. —Dean Foust

PRODUCT PEEK

WILL GE BRING GOOD THINGS TO CAMERAS?

GENERAL ELECTRIC got out of the consumer-electronics business years ago. But to woo a new generation of buyers, the company now known for wind turbines and jet engines has decided to lend its brand name to a new line of digital cameras and photo printers. "We are looking at the products that connect with young people," says Marc Bertino, president of GE Trademark Licensing.

Under a licensing agreement, eight digital cameras and a photo printer will be designed and marketed by a startup to be sold worldwide under the GE brand. In March, General Imaging in Torrance, Calif., will unveil the gadgets at the annual Photo Marketing Assn. trade show in Las Vegas. Prices haven't been announced, but the cameras will be available in the U.S. in mid-April. ("Introducing the first digital cameras worthy of the GE name," reads the slogan on General Imaging's Web site.)

GE and General Imaging executives won't disclose their financial arrangements or the names of major investors. But it's clear that GE had a big hand in setting up its licensee. Last summer it persuaded Hiroshi Komiya, the former president of camera



LICENSED TO SHOOT
Eight cameras will carry the GE name

maker Olympus Imaging, to give up retirement to

start the company. General Imaging's chief designer is Takeyoshi Kawano, the man who created the Sony Walkman, the Sony VAIO laptop, and the Olympus Stylus camera series.

Few industry analysts believe putting the GE name on new gadgets will strengthen the brand. The digital camera market is already mature, they say. And there's a risk of diluting the GE name should the licensee have quality problems. Given GE's history in consumer electronics, says Geordie McClelland, director of strategy at branding consultancy Straightline International, "consumers may well assume that the products were made in-house." —Olga Khav

NOVEL IDEA

A DARK AND STORMY SITE

AIMING TO BURNISH its Web 2.0 credentials, Penguin Books in the U.K. is hosting a wiki Web site that allows people to write a novel collectively. So far the experiment has been playfully challenging the notion of the wisdom of crowds.

Since its launch on Feb. 1, the novel-in-progress at amillionpenguins.com has grown from a single, Penguin-supplied sentence ("There was no possibility of taking a

walk that day," the opening line from *Jane Eyre*) to 36,000 words and 11 different versions with 59 characters, including a dancer who tangoes people to death. The content changes just about every minute as the wiki's 1,300 registered users worldwide rewrite the story, with some 8,500 individual edits so far.

About 75,000 people have visited the wiki, which Penguin now locks for two hours a day to give its volunteer monitors—a few Penguin employees and eight graduate students

from Leicester's De Montfort University—time to absorb changes and to delete pornography and obscenities. Jeremy Ettinghausen, head of digital publishing for Penguin UK, praises the "astonishingly creative" work he has seen. As for initial plans to publish the novel when the five-week wiki ends: "That would be virtually impossible because of the way the wiki has evolved," he says. "But I am looking at how we could produce an e-book."

—Elizabeth Woy



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AUTO DIDACT IF YOU CAN FIND A BETTER BOOK...

LEE IACOCCA is mad as hell. "Let's tell 'em all we've had enough," writes the 82-year-old onetime savior of **Chrysler**, in *Where Have All the Leaders Gone?* to be published in April by **Simon & Schuster's** Scribner imprint.

What's wrong with America? Low voter turnout, the Iraq war (including Abu Ghraib), Dick Cheney's energy task force, unfair trade, the national debt, flabby education and children, Richard Grasso's pay package, and—as the title implies—inept leaders. High on that list: George W. Bush. "We've got a gang of clueless bozos steering our ship of state right over a cliff," Iacocca opines.

Among Bush's failings, says the author, who supported the President in 2000: He alienated America's allies and, perhaps, Detroit—Iacocca is still steaming over the months-long delay preceding Bush's 2006 meeting with the heads of **GM, Ford, and Chrysler**. "Bush had time to meet with the winner of *American Idol*, but he couldn't squeeze in the leaders of the auto industry."

Iacocca lists "Nine C's of Leadership," by which he says Presidential and CEO

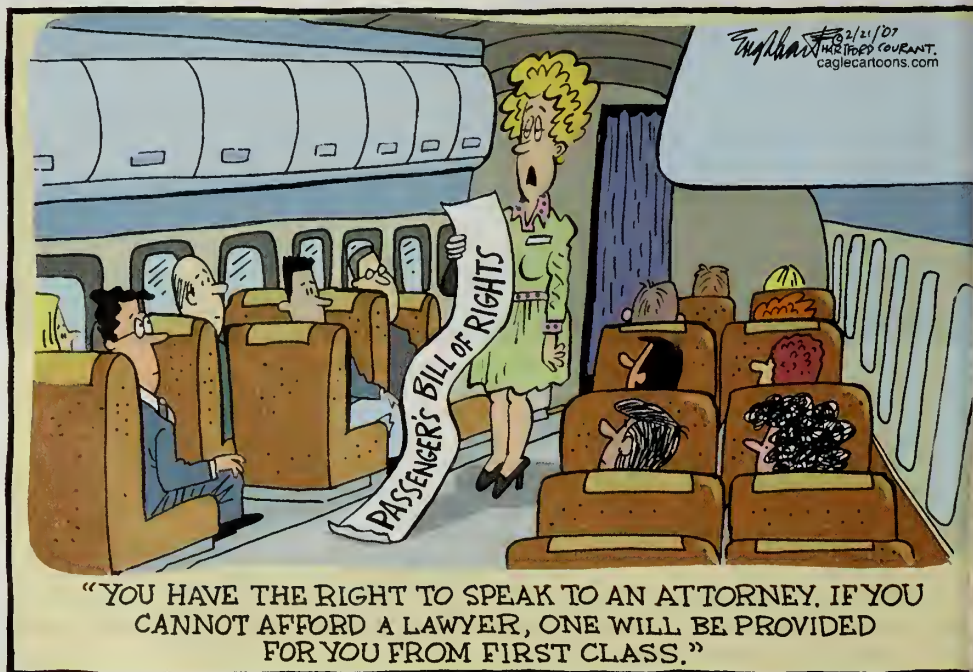
candidates should be judged. (First, "curiosity;" last, "common sense.") And with talk of Chrysler being spun off from Daimler, readers may be interested to know that Iacocca likes current DaimlerChrysler CEO Dieter Zetsche. He also sketches a plan to revive the U.S. auto industry—one that involves cutting losses and the collaboration of carmakers, the unions, and government.

What prompted the book? Simon & Schuster CEO Jack Romanos says he called Iacocca after seeing his 2005 Chrysler TV ad that also featured rapper Snoop Dogg. "He definitely had something to say," says Romanos. The unhappiness with the Administration came as no surprise. "We expected him to unload on Washington, and he didn't disappoint," Romanos says. "He didn't sell 6 million copies of his previous work by pulling his punches." —Hardy Green



ECO-LIMOS

SOME QUIET but high-wattage models may steal a bit of the limelight at the Academy Awards: More green cars than ever are ferrying Hollywood's environmentally friendly stars to the red carpet, thanks to Global Green USA, a nonprofit that supplies eco-rides for the event. This year the tinted window, luxe version of Toyota's Prius hybrid—which was Cameron Diaz' ride a few Oscars back—may be upstaged by a plug-in version that gets 100 mpg. And look for a leading-man type to screech up in a fast-as-it-looks battery-powered Tesla sportster. Zebra Car's Xebra, a petite electric three-wheeler (above) is also slated to make its debut, probably wrapped around a diminutive starlet. —Adam Astor



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**What do you call a year in which you sell 63 million
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COMPETITION AN ASSAULT ON FORTRESS BLOOMBERG?

MARC BENIOFF, chief executive of Salesforce.com, likes to take on the big guys. In the 1990s, his startup set out to compete with Siebel Systems, the customer-management software giant, and wound up playing a major role in upending it. Now Benioff has a far more entrenched player in his sights: Bloomberg, the dominant provider of financial information to Wall Street.

Bloomberg's \$1,500-a-month terminal is considered essential gear for stock and bond traders, who value its real-time market data, analytical tools, and financial news. Benioff isn't targeting hard-core traders but rather the roughly half-million U.S. financial advisers and stockbrokers, some of whom also hold Bloomberg subscriptions.

Salesforce.com's new wealth-management service,

slated to be unveiled on Feb. 27, costs \$500 a month per user. It combines the company's usual customer-relationship-tracking features with data streams and market intelligence from a range of free or for-a-fee sources, including Thomson Financial and Dow Jones. Predicts Benioff: "We're going to move Bloomberg off the desktops of the brokerages and replace it with commodity pcs and Internet services."

The first customer, Merrill Lynch (which has an equity investment in Bloomberg), has signed up for 25,000 subscriptions for financial advisers, but is leaving Bloomberg terminals on the desks of its traders, according to Salesforce.com.

As with a Bloomberg subscription, financial advisers using Benioff's service can set up alerts when information affecting their clients comes across the wires, tap into fully integrated e-mail or Web phone services to call those investors, and monitor



every communication for regulatory compliance purposes.

Analysts who have been briefed by Salesforce came away impressed. "I bet there are a lot of people on Wall Street who would like to get

out of paying the fees that made Mike Bloomberg a billionaire," says Bruce Richardson of AMR Research. But Richardson and others in the industry say Benioff's latest target will be much harder to damage than Siebel System was. "Bloomberg's base is built on bedrock," says analyst Jack McConville of the McConville Group. Bloomberg declined comment.

Undaunted, Salesforce plans to use the financial adviser desktops as a beachhead, both at big Wall Street firms and at smaller regional operations. Bloomberg, unlike Salesforce, offers few customer-

management features. Once he gains a foothold, Benioff figures, he can expand into new markets with banking, mortgage, insurance, and capital markets editions of the service. "If we succeed, we'll define the future of the financial-services workstation," he says.

—Steve Ham

QUESTION OF THE WEEK

Aflac's board has announced it will give shareholders an advisory vote on executive compensation starting in 2009. Is investor "say on pay" a good idea?

"Shareholders should absolutely have a say on executive pay. The big question is: How will it be executed? Will small individual investors have a chance to be heard?"

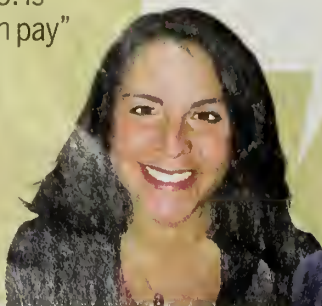
Michelle Leder, founder and editor, footnoted.org

"Bad idea. It substitutes a shareholder referendum for the business judgment of the board and will make it difficult to hire and retain the most qualified senior executives."

Martin Lipton, founding partner, Wachtell, Lipton, Rosen & Katz

"Typical! The guys who don't need to do this are doing it. I like the resolution, but it's unfortunate that only the good guys do this."

Jim Cramer, markets commentator, TheStreet.com; host, Mad Money with Jim Cramer



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**Industry Average
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“Sounds like [Julie Roehm] really just didn't want to be there.”

—Jeff Guttenberg
Geneseo, N.Y.



THE POLITICS OF PRIVATE EQUITY FUNDS

I SUPPOSE I shouldn't have been surprised when "Cranking up the money machine" (News & Insights, Feb. 12) mentioned several large private equity fund entrepreneurs among leading investors in Hillary Clinton's and Barack Obama's race for President of the U.S. After all, these guys are the experts at taking large public entities private.

In fact, Bain Capital co-founder Mitt Romney has a chance at actually being America's first private equity President, following Bush's successful reign as America's first MBA President. Perhaps we're seeing the next really big opportunity for smart global money, moving from private equity funds to private sovereignty funds.

—Alan H. MacDonald
Sanford, Me.

ROEHM'S MYRIAD MISSTEPS AT WAL-MART

"MY YEAR AT Wal-Mart" (People, Feb. 12) was interesting but highlights Julie Roehm's shortcomings.

Ms. Roehm should have realized that change is evolutionary, not revolution-

ary. As one Wal-Mart Stores Inc. insider reported, "when Julie walked into a room it was always about her, nobody else. Frankly, her ego got the best of her. Instead of hitting the ground running, she should have taken the time to understand the best way to implement change and build allies within the company."

That Roehm has not yet landed another executive position may be indicative of the fact that her time in the spotlight is over. Next time, she should spend more time on techniques that will make her a successful manager.

—Richard Meyer
Simi Valley, Cal.

THERE'S ONLY ONE way to change Wal-Mart Stores: Open up new stores under different brand name. You might want to call it, um, Target.

—Ken Leebo
Marietta, Ga.

IT'S ASTONISHING THAT Roehm would think visiting so many ad agencies that wanted the Wal-Mart business would be a productive use of her time, especially as she had to miss the politically important Friday morning meet-

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BusinessWeek
 MARCH 5, 2007 (ISSN 0007-7135) *** 4024

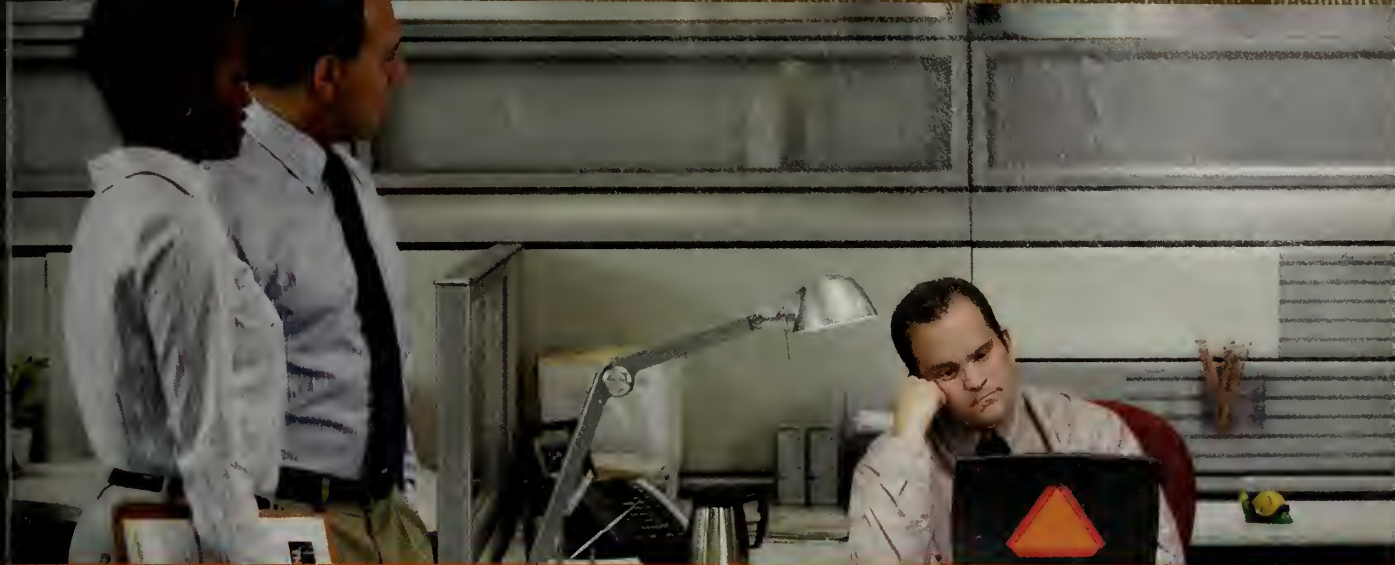
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ReadersReport

ings to do so. Sounds like she really just didn't want to be there.

—Jeff Guttenberg
Geneseo, N.Y.

THE BEST WAY TO GIVE SOLAR PANELS A BOOST

"GREEN HOMES: THE price still isn't right" (Environment, Feb. 12) states that "new federal and state subsidies could cut the cost of solar panels in half." Of course, if federal or state subsidies could do such a thing, we should subsidize virtually everything. Better yet, why not make them free?

Rather, what these subsidies actually do is distort markets for private goods by shifting the payment for the goods from the buyer to the taxpayer. If consumers experience a few more consecutive years of more than 10% increases in electricity rates (a good bet if plug-in electric cars are successfully marketed to the public), solar panels will not require a subsidy to be sold. Instead, consumers will be clamoring for them, and investment capital will flow where it belongs in order to supply them.

The alternative is a gradually increasing federal tax on electricity consump-

tion, with funds used to eliminate other pernicious, regressive taxes. This would give consumers an incentive to invest now in solar panels with the knowledge that they will become more valuable as time goes on.

—Jonathan Hains
Brookside, N.J.

STEM-CELL THERAPY IN CHINA: A PATIENT SPEAKS

I WAS THE patient mentioned in "Stem-cell refugees" (Global Business, Feb. 12) who saw University of California at Los Angeles neurologist Dr. Susan Perlman immediately before and after my Chinese stem-cell treatments.

The article reported that "there were modest but medically significant results, but they wore off."

One immediate improvement was a return of feeling in one foot, but that disappeared while still in China, which I dutifully reported to Dr. Perlman. She gave me a battery of tests, most of which showed improvement. "Transient" was how she described only my brief foot improvement. I continue to show improvement in walking and function three months later, and fully intend to return to China in the

future for additional treatments. I see it as the only game in town. My country is long on analysis, but short on hope.

—Kim Poole
Tucson

WHAT'S THE FUTURE FOR BROADCAST CHANNELS?

THE MAJOR PROBLEM faced by carriers entering the TV market is how to assess the role of broadcast channels ("Light speed's slow start," InfoTech, Feb. 12).

The infrastructure needed to support broadcast IPTV (Internet-protocol television) is different from that used to support the other approaches. TV delivery becomes more of a traditional Internet application as it moves toward store-for-play. If viewers are moving to more personalized video experiences, then spending money to deliver broadcast over IP a good idea?

—Tom Nollen
Voorhees, N.J.

HOW TO TALK TO CONGRESS ...OR A JOURNALIST

I READ WITH interest Richard Durham's roundup of advice for CEOs called to testify before Congress, "Excuse me,

AmericanAirlines, AA.com and We know why you fly are marks of American Airlines, Inc.



Iguazu Falls on the Argentina-Brazil border

r. Chairman..." (Up Front, Feb. 12). Executives who plan to be interviewed by journalists would do well to heed Inham's advice, as well.

Over the past 16 years, I have had the privilege of working with countless executives as they prepared for interviews, both friendly and otherwise. The adage of not arguing with people who buy ink by the barrel still holds true. Nothing is ever gained by long-windedness, contentiousness, or lack of preparation.

—Alan Braverman
Pomona, N.Y.

VOLATILE REITS? NOT BY THIS YARDSTICK

YOUR ARTICLE "Have REITs lost their footing?" (Personal Finance, Jan. 1999), the author claimed REITs have become more volatile and more correlated with other stocks. Actually, REITs have become steadily less volatile over the past 16 years as measured by the standard deviation of monthly price returns. Even using the author's measure—how often a REIT stock moved 1% or more in a day—volatility has shown a steady 29% decline from late

1998 through the end of 2006.

The correlation between REIT returns and those of the Standard & Poor's 500-stock index also has declined over the last 16 years. Academic studies attribute the decline to an influx of institutional investment.

—Brad Case
Vice-President, Research & Industry
Information
National Association of Real Estate
Investment Trusts
Washington, D.C.

Editor's note: As the story makes clear, we were focused on a shorter time period over which the volatility and correlations went up.

BOMBARDIER FLEXJET TAKES ISSUE

WE AT BOMBARDIER Flexjet, having just closed a profitable year, were shocked to read "One jet, 16 owners, big problems" (News & Insights, Jan. 29) stating that Flexjet has "severe growing pains" and has, along with competitors, "lost hundreds of millions." That is far from true, as *BusinessWeek* would have learned had Flex-

jet been sought for comment. In fact, none of the other problems mentioned were true of Flexjet. Our outstanding performance is testament to the viability of the fractional jet ownership model and diligence of Flexjet employees, whose efforts have resulted in our singular success.

—Sylvain Levesque
Bombardier Flexjet
Dallas

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A Sweeter BlackBerry

When **Research In Motion** introduced the handsome BlackBerry Pearl last fall, it instantly created Pearl envy among users of the highly competent, though definitely unstylish, standard BlackBerrys. But many users resisted the tiny Pearl, mainly because they liked the full-size keyboard on the old models. The new BlackBerry 8800 may prove much harder to resist.

Priced at \$295 with a two-year service contract from Cingular, the 8800 retains most of the Pearl's features, including a shiny black-and-chrome finish and a Pearl-like roller ball for navigation in place of the traditional BlackBerry scroll wheel on the right side of the unit. I found the ball a bit over sensitive, but its central position ends the chronic right-handed bias of older BlackBerrys.

Functionally, the 8800 is an updated version of the current BlackBerry flagship, the full-size 8700. It's about the same width as the 8700 and a smidgen longer, but a noticeable 5 mm thinner. Despite getting skinnier, the 8800 has a larger battery than the 8700, so it runs longer.

THE PEARL WAS THE FIRST BlackBerry with a camera, which made sense because RIM was going for the consumer market. But in response to corporate and government customers, who are likely to buy the bulk of the 8800s and are either indifferent or hostile to multimedia, RIM skipped the camera. Instead it included a feature most business customers will find a lot more useful: a global positioning satellite receiver with TeleNav navigation software. Maps are much easier to read on the 8800's big, high-resolution display than on most wireless phones.

There are a few problems. Unlike Sprint and Verizon Wireless, Cingular doesn't provide network data to help the BlackBerry's GPS do its job. This means it can take the 8800 a couple of minutes to figure out where it is. In general, the navigation software was less accurate and more easily confused by deviations in route than other software I have tried, though TeleNav says improvements are in the works. Minor glitches aside, navigation is a welcome addition.

The BlackBerry 8800 includes the music player and video player from the Pearl, but they are nowhere near as good as the media players found in most cellular handsets. The 8800 also features Cingular's walkie-talkie-like push-to-talk service, though this is useful only if you communicate regularly with a group of Cingular push-to-talk customers. The Web browser is adequate, but I wish the 8800 would run on Cingular's fast 3G network rather than its medium-



BLACKBERRY 8800

speed service, called EDGE. One other gripe: If you want to add your own applications to your BlackBerry, there are far fewer options than on Palm or Windows Mobile device.

This brings us to e-mail. In an increasingly crowded field of e-mail-capable smartphones, outstanding messaging abilities remain the compelling reason for choosing a BlackBerry over the competition. Like all BlackBerrys, the 8800 is at its best in a business environment where a BlackBerry Enterprise Server is part of the setup. This lets the BlackBerry become a true extension of your desktop, with messages delivered nearly instantaneously, and calendar and contact changes synchronized between the device and the server as they are made.

There are other routes to e-mail if you can't use the Enterprise service. You can connect directly to most Internet service provider accounts and some corporate systems. If your corporate system is blocked by a firewall, you can run BlackBerry Mail Connect software on your desktop to redirect mail to your handheld, though you can't delete mail from the server or sync calendar items and contacts this way.

The 8800 has a larger, easier-to-use keyboard than the Pearl

The 8800's keyboard, with just one letter per key vs. two on most Pearl keys, is easier to use. This and a wide range of one-key shortcuts that work only on full-size BlackBerry keyboards will lead a lot of buyers to conclude that bigger is better. ■

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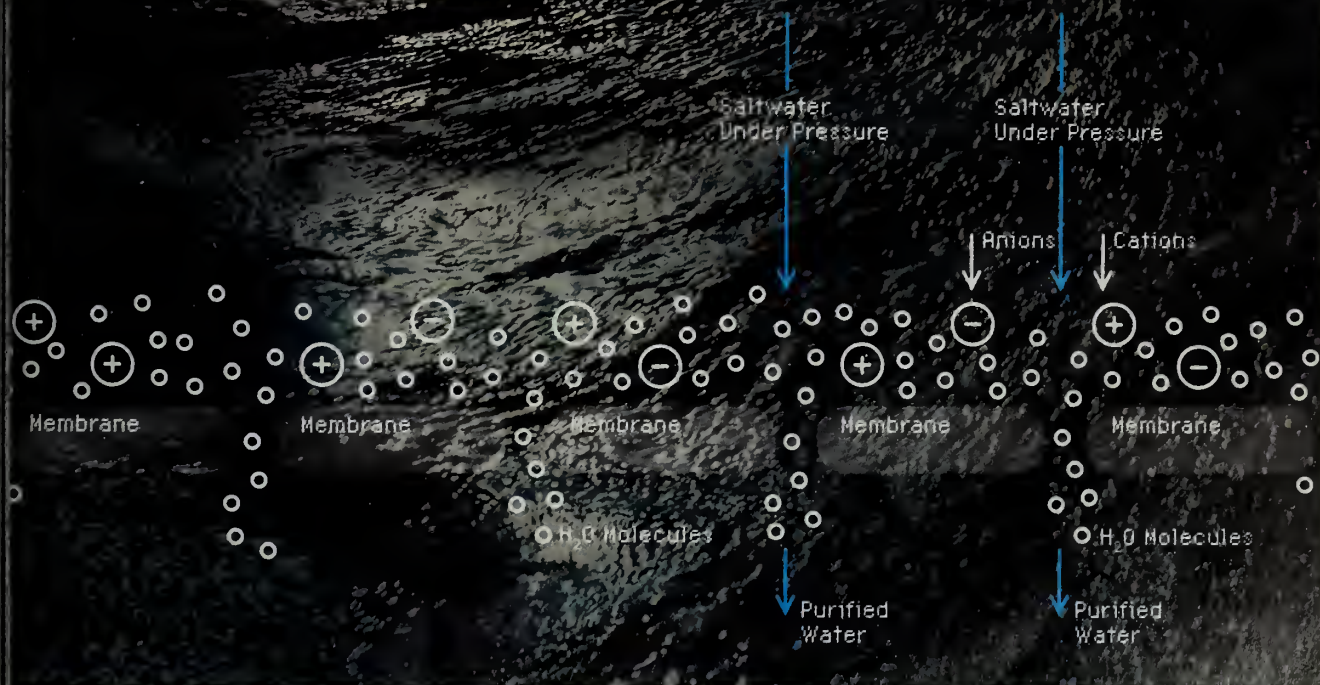
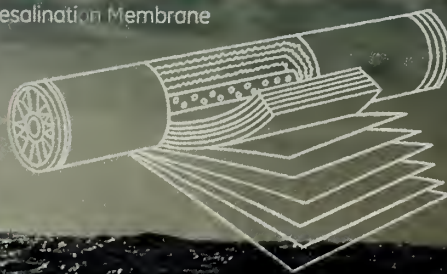
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TV's Boomlet from Election '07

Normally, 2007 would be considered an “odd” year in the local TV business. Odd in that there are no national elections and, as a result, not much in the way of political advertising dollars. But 2007 is shaping up to look more even than odd. Numerous candidates—23 have expressed an interest in running for President so far—are set to spend a record amount

on advertising well in advance of the runup to November, 2008. Local TV stations could pull in \$700 million this year, more than twice as much as they did in 2005, the last odd year.

Bear, Stearns & Co. media analyst Victor Miller figures that by the time the votes are tallied from the Presidential and congressional elections 20 months from now, candidates will have poured a record \$2.5 billion into TV spots. Great for local broadcasters, right? Yes and no. The political bounty will help offset tepid spending by other traditional advertisers and could certainly pretty up the balance sheets, as the abundance of private-equity loot makes cashing out all the more tempting. But the easy political money could also keep local stations from tackling issues that, in this YouTube world, make their business among the most seriously challenged in media. (*BusinessWeek* parent The McGraw-Hill Companies owns four local TV stations.)

WHAT MAKES 2007 SO DIFFERENT? For one thing, five states, including California and Florida, are expected to move their primaries up to the first week of February next year, creating a Super Super Tuesday in which 41% of all delegates get picked. Needless to say, the flurry of spending ahead of that key date could begin this fall. Moreover, since neither the President nor the Vice-President is running in 2008—the first time this has happened since 1952—most candidates lack the familiarity of incumbency and will need to spend heavily to introduce themselves to the electorate. Ranked against other national advertisers on local TV in election years, politicians are now second only to automakers. A decade ago, political advertising didn't even make the top five.

Television executives are understandably intoxicated by the coming wave of political money. One of them can barely contain his glee. Politicians don't get “Brownie points for being No. 2,” he says. “So these candidates spend like drunken sailors near the end.” But here's the rub: Rabid candidates raising and spending tens of millions of dollars for local spots



will almost certainly push out other regular advertisers. And these companies already have many more ways to get their message out—including the Internet, of course. Crunching the numbers is instructive: When you remove the double-digit gains from political advertising in 2006, ad revenue growth at 10 of the top TV station owners ranges from 5% to -2%.

Such numbers don't bode well for a business in unprecedented upheaval. Local TV stations are spending millions to meet a federal mandate to be fully digital in 2009. That will allow them to offer more channels, but there's no guarantee that viewers will tune in. (Blame such distractions as the iPod and Xbox.) Yes, broadcasters have been buoyed by the prospect that the cable operators will finally pay them to carry the local stations (before, broadcasters with their free-over-the-air programs were treated as free), but those revenues are still not certain.

Broadcasters will thrive on early ads. But it's a mixed blessing

That's why shareholders are restive and pressuring big media groups to put local stations on the block. New York Times Co. sold its 9 TV stations in January to private equity; CBS dumped 7 in February. Clear Channel Communications plans to sell its 42 stations as part of a plan to take itself private, while Tribune Co. could auction off its 19 stations.

Smart TV guys won't take their eye off the ball even as the political dollars stream in. “All advertising is good for us,” says Tom Kane, president and CEO of the CBS Television Stations Group. “But we certainly don't take the focus off those who are with us year in and year out.” Spoken like an executive who doesn't see the world in odds and evens. ■

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How Long Can the U.S. Count On Foreign Funding?

As the dollar sags and other investments beckon, a shakeout looms

U.S. ECONOMY In a speech in 2004, then Federal Reserve chairman Alan Greenspan said: "It is difficult to imagine that we can continue indefinitely to borrow savings from abroad at a rate equivalent to 5% of U.S. gross domestic product." Well, by the third quarter of 2006, the U.S. was dependent on foreign lending to the

effect of more than \$860 billion, or about 6.5% of GDP, and the need for foreign money will most likely hang over 6% through 2007. The big question: Can the U.S. continue to count on this massive amount of foreign capital to fund its overseas obligations and finance its economic growth?

The question seemed especially urgent after the Treasury Dept.'s eye-opening report that net inflows of foreign capital into long-term U.S. securities fell to only \$5.6 billion in December (chart). It was the skimpiest monthly total in almost five years. Consider that during the first half of 2006 the U.S. needed, on average, more than \$70 billion a month in foreign funds to finance its current account deficit, made up mainly of the trade deficit, along with net investment income that the U.S. owes to foreigners and certain government transfers.

The greatest potential vulnerability lies with the U.S. dollar and its role as the balancing agent between the financing needs of the U.S. and the willingness of foreigners to supply those funds. The fear is a sudden lunge in the greenback. The U.S. will always obtain the foreign financing it needs, but what level of the dollar will it take to attract those funds? U.S. indebtedness is a key reason why the dollar has already declined 27% against a basket of major currencies since early 2002.

THE SHARP FALLOFF in December capital inflows does not appear to presage any serious trouble, but a drop of that size bears watching in coming months. The monthly Treasury data are subject to big swings from month to month, and for all of 2006, foreign funds flowing into long-term U.S. securities totaled \$896 billion, more than enough to cover the red ink in the current account deficit. The December drop came as the U.S. continues to face dearth of homegrown savings. That's pressure enough on the U.S. to draw in the capital it needs. But against this already shaky backdrop, two new trends are emerging that add even more weight on U.S. finance and the dollar.

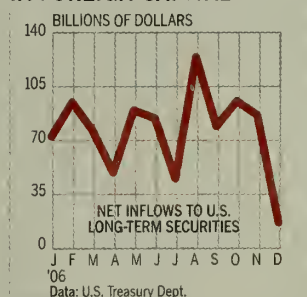
First, there is increasing evidence that foreigners are diversifying their assets away from dollar-denominated securities toward other currencies. China, for example, recently announced it is forming a new agency to

diversify \$200 billion of its \$1 trillion in foreign exchange reserves. Emerging-market economies are beginning to discover that U.S. investments, while relatively low risk, are also relatively low return compared with other investment opportunities around the globe.

FOR NOW, AT LEAST, the impact of these diversification efforts, while potentially harmful to the dollar, are less than clear. For example, even if China diverts \$200 billion from U.S. assets, it will continue to amass about that much each year as a result of its trade surplus and incoming direct investment, notes Donald Straszheim at Roth Capital Partners. Nevertheless, countries from OPEC to Asia are taking a second look at their international portfolios, and the trend is certain to place further downward pressure on the dollar.

A second new threat is homegrown: Chances of outright protectionist measures, such as tariffs, appear to be rising. The new Democratic Congress shows signs it will be far more activist on issues affecting trade, especially with China and countries that manipulate their currencies to gain a competitive advantage.

A DECEMBER DROP-OFF IN FOREIGN CAPITAL



After several months of good news on the U.S. trade deficit, the December gap widened sharply, to \$61.2 billion, up from \$58.1 billion in November. That rise brought the annual deficit to \$764 billion, with bilateral gaps with China, the European Union, and Japan, respectively, making up 30%, 15%, and 11% of the total.

Given the competitive pressures on U.S. producers, especially automakers, from the weakness in the Chinese yuan and the Japanese yen, companies are sure to be more aggressive in pressing lawmakers for relief. The House of Representatives leadership has already given the White House 90 days to present Congress with a plan

to address several trade issues involving China, Japan, and the European Union. The implication is that after 90 days, it will come up with its own plan.

Any U.S. action that reduces Chinese imports, however, also will result in less foreign exchange for the Chinese to invest. That could make the Chinese less interested in the auctions of U.S. Treasury securities. China is second only to Japan as the largest holder of U.S. Treasury issues.

THE CORE OF AMERICA'S NEED for foreign capital lies in its lack of domestic savings. That savings pattern seems likely to continue for a long time, given the long-term pressure on the federal budget and the current downtrend in personal savings.

For example, in the third quarter of last year, net private saving by U.S. consumers, businesses, and governments totaled \$224.9 billion. The retained earnings of U.S. businesses accounted for all of that and more. The household and the government sectors were both net drains on U.S. savings. Households actually spent \$111.7 billion more than they earned in the third quarter, and the personal savings rate for all of 2006 was negative for the second year in a row, something that hasn't happened since the Depression years of the 1930s. Plus, the federal government's outlays in the third quarter exceeded its receipts by \$165.6 billion.

In fact, U.S. savings financed only about one-quarter of last year's U.S. net investment, which excludes the outlays needed to replace depreciated equipment, buildings, and such. Foreigners supplied the remaining

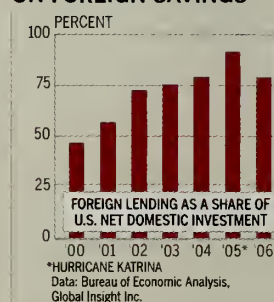
three-quarters (chart). The savings issue is critical, in part, because investment is the lifeblood of future economic growth, and that growth requires savings, whether they are homegrown or borrowed from abroad.

The U.S. will continue to receive a large share of the world's excess savings, especially from those

developing economies that don't have financial institutions and market systems to allocate their huge foreign exchange reserves to domestic uses.

However, the dollar will remain vulnerable, especially as the U.S. faces the enormous financing requirements created by the retiree and health-care needs of

A GROWING DEPENDENCE ON FOREIGN SAVINGS



the baby boomers. In the near future, the U.S. will require either ever more foreign capital or an increased rate of domestic savings.

Absent the latter, the U.S. is sure to eventually bump up against its foreign borrowing limit. The day of reckoning will be at the point when foreigners demand more for their money, either through a weaker dollar, higher interest rates, or both. On the way there, any more reports of waning interest in U.S. securities are likely to attract much more attention in the currency markets, to the detriment of the greenback. ■

E-COMMERCE

Cash Registers are Ringing Online

WHEN IT COMES to analyses of consumer spending, online sales are often overlooked. But retail e-commerce sales growth far outpaces that of overall consumer spending and shows no sign of letting up. That means online sales will only grow in importance when it comes to gauging the health of consumer spending.

Fourth-quarter retail e-commerce sales surged 24.6% from the previous year, according to the U.S. Census Dept. That rapid growth is a reason why fourth-quarter non-auto and non-gasoline retail sales looked much better than the widely followed chain-store sales figures.

The quarterly e-commerce figures also far exceeded the government's strong monthly figures for nonstore retailers, which includes catalog and other forms of direct sales. Fourth-quarter nonstore sales grew 7.6% from the year before, beating most other retail categories.

As more consumers buy online, e-commerce sales account for a larger

chunk of overall retail spending. Sales of \$108 billion in 2006 topped those at electronics and appliance stores. And in the final quarter of 2006, online shopping accounted for 3% of total retail sales, nearly double the share at the end of 2002.

The torrid growth of online retail sales

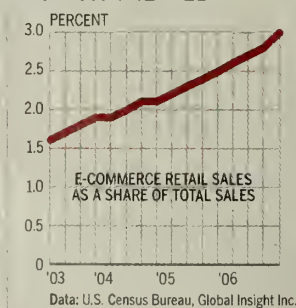
should continue through 2007.

According to the research firm Cowi & Co., e-commerce retail sales will climb another 20%, to \$129 billion, in 2007. One apparent reason for the ongoing strength is that e-commerce retailers are doing a good job. The fourth-quarter American Customer Satisfaction Index from the Stephen M. Ross School of Business at the University of Michigan showed an improved score for e-commerce businesses. In particular, online retailers are one of the highest-rated among the 43 different industries covered by the survey.

While the law of large numbers means growth of more than 20% per year will be hard to sustain, e-commerce sales are expected to climb at a double-digit pace for the rest of the decade, reaching 4.3% of total sales by 2010. ■

—By James Mehring in New York

MORE CONSUMERS SHOP ON THE WEB

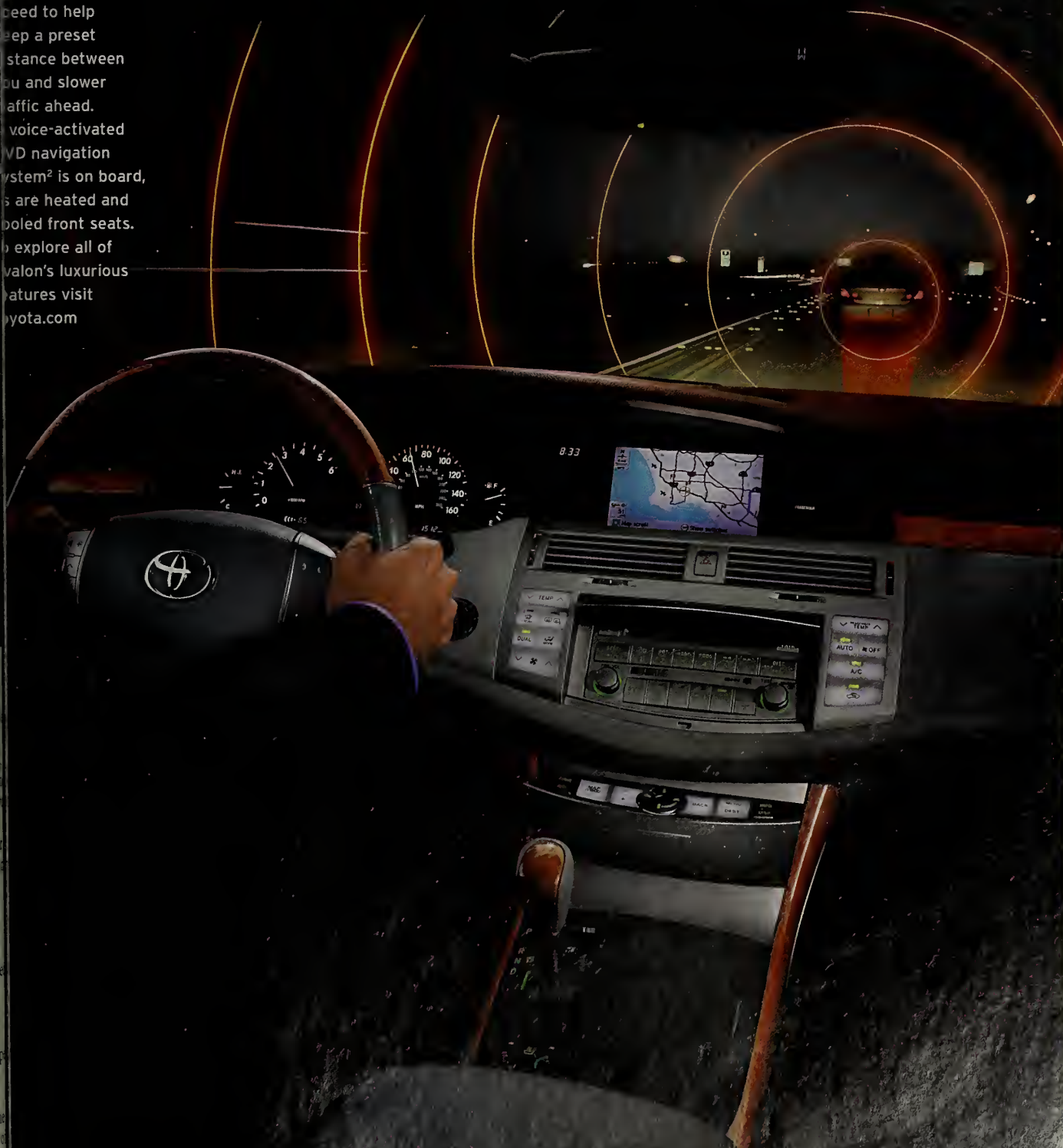


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 **TOYOTA**
moving forward

The Business Week

News you need to know

EDITED BY HARRY MAURER



Red-Faced JetBlue What a difference an ice storm can make. **JetBlue Airways**, which pledges to “bring humanity back to air travel,” suffered a frigid blast to its customer-friendly reputation after Valentine’s Day foul weather left hundreds of passengers stranded on runways at New York’s Kennedy Airport for up to 10½ hours.

That alone would have made for corporate chills. But the storm, which caused JetBlue to cancel 279 flights on Feb. 14, also overwhelmed operations on Presidents’ Day weekend, leading to a six-day saga of more than 1,100 cancelled flights. After **CEO David Neeleman’s** highly public mea culpas, the airline introduced a Customer Bill of Rights, promising passengers vouchers or refunds for delays or cancellations. On Feb. 21 the carrier said it would post an operating loss in the first quarter, partly owing to \$30 million in storm-related expenses, and cut its operating-margin forecast for the year.

See “An extraordinary stumble at JetBlue,” page 58,
“Neeleman explains himself,” page 90

ONLINE “JetBlue’s fiasco could improve flying,”
www.businessweek.com/go/tbw

Radio Romance After months of rumors crackling over the airwaves, **Sirius Satellite Radio** and **XM Satellite Radio** announced plans to merge on Feb. 19, striking a \$13 billion deal—and facing high regulatory hurdles.

See “XM and Sirius: What a merger won’t fix,” page 31

ONLINE “Satellite static: The XM-Sirius merger,”
www.businessweek.com/go/tbw

A Breath of Inflation Don’t get sick, and don’t smoke—it’ll cost you. The **Bureau of Labor Statistics** announced on Feb. 21 that medical costs rose 0.8% in January, for the biggest leap since 1990, while tobacco products jumped 3.1%. Those items caused the “core” **consumer price index** to rise more-than-expected 0.3%. The “headline” CPI, including food and energy, rose 0.2%. Bond prices fell as traders concluded that the Fed was less likely to cut rates.

Airbus Divided The troubled planemaker’s restructuring plan is caught in a political downdraft. France and Germany are squabbling over who’ll shoulder the brunt of \$6.5 billion, three-year cost-cutting program that’s likely to entail 10,000 job losses. The flareup forced management to postpone a scheduled Feb. 20 unveiling of the plan. French **President Jacques Chirac** and German **Chancellor Angela Merkel** have scheduled talks for Feb. 23.

See “Airbus revs up the engines,” page 4

Retailer Results Looks like former **CEO Bob Nardelli** got out just in time: **Home Depot** on Feb. 20 reported rickety fourth-quarter numbers, with profits tumbling 28% and same-store sales down 6.6%, the first such slip in the company’s history. Another behemoth, **Wal-Mart**, fared better after going back to low-price basics: Profits up 10%, and same-store sales up 1.6% for the quarter.

ONLINE See “Wal-Mart goes abroad for growth,”
www.businessweek.com/go/tbw

Dell’s New Team **CEO Michael Dell**, back in the Dell dust since January, is signing heavy hitters. On Feb. 16 the sputtering computer giant named **Ron Garriques**, chief of **Motorola’s** cellphone business, to head its global consumer division. That came two days after Dell hired turnaround ace **Mike Cannon**, CEO of electronics assembler **Solectron**, to lead its manufacturing, procurement, and supply chain operations. Analysts expect Dell to continue the hiring drive as many longtime managers have exited recently.

ONLINE See “Dell’s new blood: Cannon, now Garriques,”
www.businessweek.com/go/tbw

Warner Music Won’t Quit Will the fourth verse be the charm? After three failed attempts at a merger with **EMI**, Warner Music again wants the two companies to waltz. On Feb. 20, Warner said it has discussed “a possible acquisition” after striking a deal with the **Independent Music Publishers & Labels Assn.** that it believes will help overcome European regulatory hostility. Among other things, it agreed to help finance the new **Merlin** initiative, which helps indie labels license music online. Warner didn’t put a price tag on the potential takeover. It offered \$4.9 billion for EMI last year.

Merck Backs Off Merck was feeling poorly after reports emerged that it was aggressively lobbying state legislators to require that girls be vaccinated with **Gardasil**, which prevents HPV, a leading cause of cervical cancer. Pharmaceutical lobbying is nothing new, of course, but in this case Merck

nd been waging its campaign partly through **Women in Government**, an advocacy group it funds. That raised the hackles of some conservatives, who fear the vaccine may encourage promiscuity, since HPV is sexually transmitted. On the advice of medical associations that think it's too early to mandate the vaccine, Merck pulled the plug on its state lobbying efforts on Feb. 20, saying it will focus instead on educating women about the importance of preventing HPV. Analysts figure Gardasil could rack up sales of \$2 billion to \$4 billion a year—the higher number more likely with mandates.

Viacom Goes Elsewhere A week after blasting YouTube for streaming shows without compensation, Viacom on Feb. 20 became the first large Hollywood player to sign with a new video site, **Joost**. Operated by **Yvette Alberdingkthijm** and **Henk Friis**, the Scandinavian entrepreneurs behind the Skype online telephone service, Joost says it can provide a “secure, efficient, piracy-proof” outlet for TV shows from Viacom’s **MTV**, **BET**, and **Paramount Pictures** units. At the outset, the content will be free. Viacom and other media outfits are all negotiating with YouTube owner **Google** to license their content to the site.

ONLINE See “Viacom juices Joost,” www.businessweek.com/go/tbw

BBVA Bulks Up Big Spanish banks have long been powerhouses in Latin America. Now they’re flexing more muscle north of the border. **Banco Bilbao Vizcaya Argentaria** said on Feb. 16 that it will acquire **Compass Bancshares**, based in Birmingham, Ala., for \$9.6 billion in cash and shares. Along with BBVA’s existing U.S. holdings, that gives the Spanish bank 622 branches in Sunbelt states such as Alabama, Arizona, New Mexico, and Texas.

Ruling of the Week

Chalk up a big one for business and another kick in the pants for plaintiffs’ lawyers. On Feb. 20 the **Supreme Court** sided with **Philip Morris**, maker of **Marlboro** cigarettes, in its appeal of a \$79.5 million punitive damages award. The court ruled 5 to 4 that the award in the case, brought by the widow of longtime smoker, **Jose Williams**, was unfair because it sought to whack the company for wrongs beyond those suffered by Williams. During a 1999 trial, the widow’s lawyer had urged the jury to consider the harm Philip Morris had inflicted on countless other smokers over the years. The justices did not, however, hand corporations what they most would have liked: a firm cap on how much a jury can dole out in such a case. In its 2003 *State Farm* decision, the court said punitive damages should be limited to a modest, though undefined, multiple of compensatory damages. In this case, the jury awarded a multiple of 97. The Williams matter now heads back to Oregon for review.



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THE FEDS

A SMALLER OPTIONS SCANDAL?

The campaign to lock up accused backdaters is moving slowly. Here's how a key case is playing out. **BY PETER BURROWS**

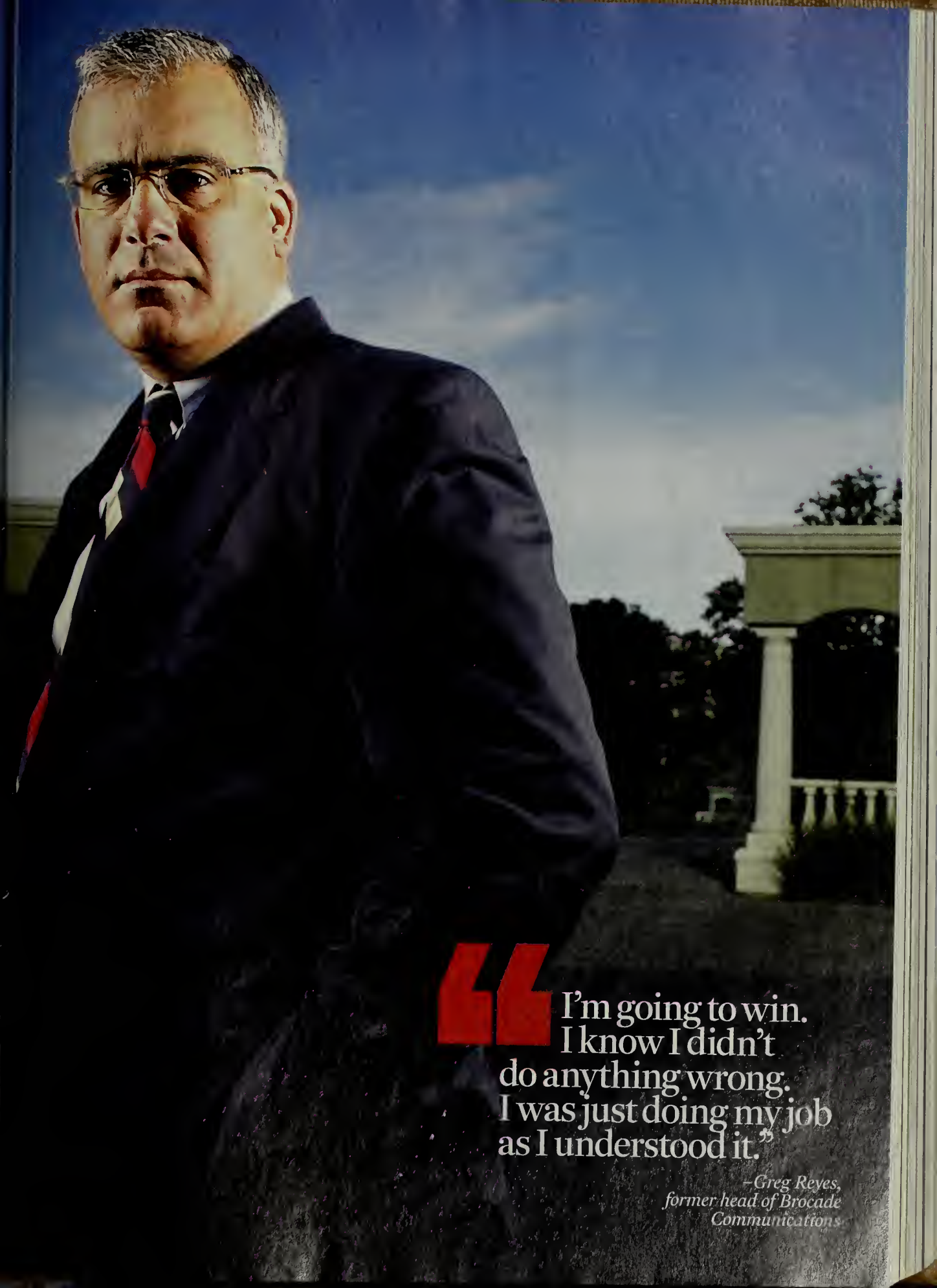
WHEN FEDERAL prosecutor Kevin Ryan stepped up to a podium in San Francisco on July 20 to announce the first criminal charges for options backdating, the issue seemed poised to become America's next great corporate scandal. The U.S. Attorney for Northern California's heavily covered case targeted Greg Reyes and Stephanie Jensen, the former CEO and human resources chief, respectively, of storage-gear maker Brocade Communications Systems Inc. in San Jose, Calif. They were just 2 of more than 100 executives under investigation for backdating at the time—and new names were being added to the list almost every day.

Since then the campaign to lock up accused backdaters seems to have lost some momentum. Only one other criminal case has been filed, against executives from Comverse Technology Inc. Ryan has resigned, as have two of the original four prosecutors on a backdating task force created at the time. That includes Chris Steskal, the original lead attorney on the

Brocade case. Although about 140 companies are under investigation by the government for backdating, few observers expect anywhere near that number of indictments. "This scandal is a mile wide and an inch deep," says Mark E. Beck, a criminal defense attorney in Los Angeles.

As legal experts take a closer look at the backdating issue, some are questioning how well it will play in court. Recent history illustrates why. Plenty of business practices that were roundly condemned by government lawyers, academics, and columnists—including allocating hot IPO shares to favored investors and trading mutual funds after market close—failed to produce the expected jail sentences. And plenty of executives whom the pundits expected to see in orange jumpsuits, such as former HealthSouth CEO Richard M. Scrushy, are walking free. "My prediction is that a lot of these cases are going to prove to be a lot murkier in terms of criminality than the seemingly stark allegations as they initially emerged," says Larry E. Ribstein, a law professor at the University of Illinois. "There will be difficulties finding out who did what and whether they knew it was wrong."





“I’m going to win.
I know I didn’t
do anything wrong.
I was just doing my job
as I understood it.”

—Greg Reyes,
former head of Brocade
Communications

That view is affirming to many executives in Silicon Valley who view the options backdating issue as a media-driven witch hunt. Many privately argue that the guidelines for setting option prices provided wide discretion to senior management and boards pre-Sarbanes-Oxley. The practice was widespread and often authorized by lawyers and accountants. And in many cases the backdating had little impact on the company's shareholders.

So far, local and federal prosecutors have managed to win a few backdating plea bargains without going to court. In recent days former Take-Two Interactive Software CEO Ryan Ashley Brant, inventor of the game *Grand Theft Auto*, pleaded guilty in New York state court to falsifying financial records, and former Monster Worldwide general counsel Myron F. Olesnyckyj pleaded guilty to federal securities fraud and conspiracy.

WHERE THE CASE IS STRONG

BUT REYES, WHOSE CASE is set to go to trial in June, has vowed to fight. As one of the wealthiest and most competitive men in Silicon Valley, he is paying more than \$1 million a month to a 20-person

legal team from Skadden, Arps, Slate, Meagher & Flom to keep him out of jail. He is facing 12 criminal counts, including 4 related to securities and mail fraud and 8 based on falsifying Brocade's books and making false filings to the Securities & Exchange Commission and the company's accountants. All told, the charges carry a maximum sentence of 105 years and \$20.5 million in fines. "I'm going to win," says the 44-year-old Reyes, who says he's worth about \$400 million. "I know I didn't do anything wrong. I was just doing my job as I understood it." Jensen has also pleaded not guilty.

This type of bluster is typical of former corporate hotshots accused of breaking the law. But dig a little deeper, and it's clear that the Reyes prosecution is hardly an ideal launchpad for the government's effort to put accused backdaters behind bars.

The toughest part of the case for Reyes appears to be the eight counts alleging that he committed "books and records" violations. According to the Justice Dept., Reyes and Jensen routinely falsified board minutes and other internal documents to hide the fact that

they were pegging employees' stock options to days in the past when Brocade shares were low. Backdating is not legal, but hiding the practice and failing to expense the backdated options is. An internal document prepared for the board's investigators indicated that 25 of grants made from Brocade's 1999 IPO to 2004 were made at monthly low. The mathematical odds of such luck are minuscule, says Erik Lie, the University of Iowa business school professor who first raised questions about backdating. "It just can't happen" without benefit of hindsight, he says.

Prosecutors have accumulated quite a bit of circumstantial evidence to support these charges. For example, Brocade's audit committee uncovered internal records that suggest one high-ranking former manager began receiving options in November, 2001, even though Reyes didn't interview him about coming aboard until Feb. 1, 2002. Richard Marmaro, Reyes' attorney, says all of this employee's options were priced on Feb. 28 and that paperwork suggesting otherwise is incorrect. Then there's the operations manual specifying that options clerks pick the lowest stock price

White-Collar Whiffs

Not everyone convicted in the court of public opinion suffers the same fate in front of a jury.

MARK BELNICK

»Top lawyer for Tyco International: Belnick was ex-Tyco CEO Dennis Kozlowski's right-hand man, yet a Manhattan jury acquitted him of grand larceny and securities fraud in 2004.

THEODORE SIHPOL

»Broker at Bank of America: Eliot Spitzer prosecuted Sihpol for participating in late trading of mutual funds in 2005, but the former New York Attorney General couldn't convince a jury.

FRANK QUATTRONE

»Credit Suisse First Boston investment banker: In August federal prosecutors dropped their case against Quattrone, who had been vilified during the IPO allocation scandal.

RICHARD SCRUSHY

»Founder of HealthSouth: Most pundits believed Scrushy had a weak case, but a hometown Alabama jury cleared him of fraud and conspiracy charges in June, 2005.

ROBERT FURST

»Merrill Lynch investment banker: The Nigerian barge transaction was one of Enron's worst, yet Furst's conspiracy-and-fraud conviction in connection with it was overturned in August.



nce the previous option grant when ringing Reyes new paperwork to sign. Marmaro insists Reyes didn't know of the manual's existence.

Powerful stuff—and there may be more like it that has not come out in public yet. But it's nothing next to some of the smoking guns that have emerged in other cases in which executives seeking to keep their backdating under wraps participate in the deliberate falsification of internal documents. And the rules surrounding record-keeping "are highly technical," says Peter J. Henning, a professor of law at Wayne State University who is co-editor of the blog White Collar Crime Prof. "It will be very easy for jurors to get lost," he says. These are not the type of issues they find appealing."

WHERE THE CASE IS WEAK

WHAT MAY BE particularly true in the Reyes case, Henning says, because the former Brocade chief did not receive any backdated options himself. That puts him in distinct contrast with Apple's Steve Jobs and former CEOs such as United HealthCare's William W. McGuire, who agreed to pay back millions of ill-gotten gains. From a prosecutorial standpoint, "the best cases are ones that involve self-dealing," says Columbia University law school securities professor John Coffee.

Another key factor absent in the Brocade case is much shareholder harm. Even if jurors believe Reyes intentionally backdated options grants to other employees, the vast majority of the allegedly backdated options were never exercised. What's more, Marmaro says, Brocade's investors didn't care a whit about backdating. The stock fell only slightly when the company announced its \$304 million restatement in early 2005, then soared 17% when Brocade sued its final report on the scandal.

Given the trivial impact on Brocade investors and the lack of any personal profit on Reyes' part, prosecutors may find it hard to make the securities-fraud charges stick. In court, Reyes' lawyers can argue that he sought only to help shareholders by making it easier for Brocade to attract and retain talent. That argument may not be enough to keep him out of jail. But, thanks to Brocade's stock performance, he is going to have a much easier time making up with a straight face than many of the other executives facing backdating charges. ■

—With Lorraine Woellert in Washington

SATELLITE RADIO

XM & SIRIUS: WHAT A MERGER WON'T FIX

Despite increasingly popular content, there's no guarantee the satellite business model will survive



BY TOM LOWRY
AND PAULA LEHMAN

WHETHER OR NOT Washington lets XM Satellite Radio Inc. and Sirius Satellite Radio merge seems beside the point. Even if they

get the nod, there's no guarantee the six-year-old business model will survive.

Sure, XM and Sirius would wring out plenty of cost savings as one company. But the two have yet to earn a penny of profit. Their combined losses for 2006 are expected to hit \$1.7 billion. And competition is everywhere. Car salesmen are pushing new iPod jacks. More than 57 million Americans now listen to some form of Web radio each week, says radio-audience tracker Bridge Ratings, compared with 14 million subscribers for XM and Sirius combined. Broadcasters are beginning to offer high definition, or HD, radio. While consumers need to buy a special receiver to get HD, which squeezes more programming into the same frequency, the service is free.

Meanwhile, 240 million folks listen to

regular radio at least once a week. And who knows what's around the corner? Maybe a form of WiMAX will be capable of streaming Web radio to a speeding car.

Here's a radical notion: Perhaps XM and Sirius should just take the satellite out of satellite radio. "Satellites are a really expensive and soon-to-be obsolete method of delivery," says Paul Maloney, editor of *RAIN: Radio and Internet Newsletter*. XM and Sirius each have already spent \$1 billion-plus to build and launch their birds, and these things last only 10 to 15 years.

XM and Sirius may never have cool hardware. But they do have decent programming, an eclectic mix that appeals to all kinds of interests, from Major League Baseball games to unsigned alternative bands. O.K., Sirius might have overpaid (\$500 million over five years) to get shock jock Howard Stern, but he draws millions of listeners each day.

Where better to sell that programming than on cell phones or Web sites? XM and Sirius are already doing it—at least to a limited extent. Their subscribers can listen to all the channels by visiting the companies' Web sites. XM provides some of its offerings to AOL Radio, and two dozen or so channels to Cingular and Alltel.

Distributing more programming through third parties would require moving beyond the current \$12.95-per-month subscription model. That could include sharing ad revenues or subscription fees with wireless carriers or Web sites. XM's deal with Cingular may provide a model: Subscribers pay an extra \$9 a month to get the XM channels, a fee that is divvied up between both companies.

XM and Sirius have built surprisingly robust brands in six years, thanks in part to pushes in such retail outlets as Best Buy Co. For media outfits trying to reach ears and eyeballs in multiple ways—including, if it survives, via satellite—a strong brand and content may well be the killer apps. ■



AUTOMAKERS

CHRYSLER AT A CROSSROADS

A buyout is all but inevitable. Here are three scenarios for possible sales, and how each one would play out

BY DAVID KILEY AND DAVID WELCH

FOR THE SECOND TIME in a decade, Chrysler is on the auction block. Even more amazing, despite nine years of woe under the ownership of Daimler-Benz, Chrysler has a line of potential buyers forming to kick its tires. Parties interested in the company or its parts range from General Motors Corp. to private equity groups and Asian automakers.

One possible outcome to a Chrysler sale would have been highly unlikely five years ago. Back then, GM controlled a

comfortable 28% of the U.S. car market, and Chrysler 13%, so a merger would have drawn closer scrutiny in Washington. Today, though, GM is on the verge of losing its global car sales lead to Toyota, and Chrysler and Ford are fighting for their very survival, so anything seems possible.

At DaimlerChrysler's sprawling Stuttgart headquarters, the decision over how to proceed has split top management and board members into opposing camps: One backs a rapid sell-off of Chrysler Group, while the other favors first completing a restructuring effort into next year to bolster

the selling price. A delay might reduce the final cost to Daimler of unloading Chrysler after subtracting its \$22 billion in health-care liabilities. But a sell-it-now crowd appears to have the upper hand. "The chance that Daimler will sell Chrysler by fall of this year before a new contract has to be negotiated with the unions, is probably 100%," says one senior Daimler-Chrysler official who asked not to be named.

Here are the most likely scenarios for buyers, and our estimates of the odds for each one happening:

GENERAL MOTORS

IT SEEMS LIKE a loopy idea, combining one flailing carmaker with another that is struggling to slim down. But this scenario has one big advantage—it would be the fastest way for DaimlerChrysler to be rid of Chrysler. If he decides to push the button on a deal, GM Chairman and CEO G. Richard Wagoner Jr. would be betting that for a negligible price he could add Chrysler's \$62 billion in yearly revenue, or much of

while cutting a big chunk of the structural costs. GM envisions selling close to 6 million vehicles per year worldwide through the combined company, but with smaller staff of engineers, accountants, public-relations people, lawyers, and so on. GM accountants and strategists estimate they could save billions a year by merging the companies.

GM would need the cooperation of the United Auto Workers—and not just on reducing health-care costs. A deal could require the loss of 10,000 to 15,000 of the combined 125,000 production workers, so GM would need to arrange a buyout of some kind, says Sean P. McAlinden, chief economist at the Center for Automotive Research in Ann Arbor, Mich. The UAW is to figure that Chrysler jobs are going to be lost in any case, and workers would get the best security guarantees under GM.

Even if all the breaks go GM's way, though, it would be a messy slog. Put simply, buying Chrysler would double down on many of GM's existing problems. GM would pare the Chrysler lineup to one retail channel focusing on the best models: the Dodge Ram pickup and Charger sedan; the Jeep Wrangler, Grand Cherokee, Liberty, and Patriot; the Chrysler 300 and minivans. Even so, GM could be left with an unwieldy 11 brands without support in the U.S. with marketing and strategy.

ODDS OF A SALE TO GM
33%

Toyota Motor Corp., by way of contrast, has three. Says Goldman, Sachs & Co. analyst Robert Barry: "Buying Chrysler would add to GM's already bloated stable of brands and could complicate its current restructuring and global platform work, saddle it with more retiree liabilities, and create challenges in the dealer network."

A sale to GM may also be the costliest scenario for DaimlerChrysler Chairman Dieter Zetsche. Executives with knowledge of GM's position say it wants Chrysler for virtually nothing. It could cost \$8 billion just to cut Chrysler down to size. And the company itself may only be worth \$5 billion, according to Banc of America Securities analyst Ron Tadross.

PRIVATE EQUITY

VIRTUALLY EVERY MAJOR buyout firm, including Blackstone Group and Clayton, Dubilier & Rice (which bought Hertz from Ford Motor last year), is looking at Chrysler's books, according to one leading investment banker who regularly works with auto companies. And private equity investors in Germany have been buzzing since 2005 about the chances of bidding for control of parent DaimlerChrysler. The allure? Investors figure they could break up the company and unlock big gains from Mercedes' luxury car and commercial truck units. Analysts estimated then that the Daimler parts were undervalued by as much as \$40 billion when DCX shares traded at about 40.

The stock price has since risen to 75 a share, but raiders still see DCX as undervalued. "You dump Chrysler, spin off the truck business, and get Mercedes for free," says a German executive privy to the conversations. Michael Raab, an analyst at private bank Sal. Oppenheim, pegs DCX's breakup value at 98 a share. Of course, if GM walks away from the table, DCX's share price may tumble, making a deal even more attractive for private equity.

Private equity firms see substantial breakup value in Chrysler alone. The Jeep brand plus its factories could bring \$5 billion to \$7 billion. At least a few of Chrysler's plants would be of interest to Hyundai Motor, Chinese automakers, Renault-Nissan, India's Tata Motors, and possibly Volkswagen. DaimlerChrysler Financial Services, almost a forgotten asset, earned about \$2 billion last year. The wild card? A private buyer would have to negotiate UAW worker buyouts and figure out who pays for it.

ASIAN AND EUROPEAN CAR COMPANIES

RENAULT-NISSAN Chief Financial Officer Thierry Moulouget has told institutional investors that

ODDS OF A SALE TO FOREIGN CARMAKERS
17%

the company won't seek to buy Chrysler or strike an alliance. But that doesn't mean the French-Japanese automaker wouldn't look at the same individual assets as private equity outfits, says one high-ranking Nissan executive.

Although Jeep has suffered from the industrywide downturn in SUV sales, it remains a strong, iconic brand with worldwide appeal, especially in regions like South America, the Middle East, and China. "In those markets, Jeep is like a luxury brand that says 'I have arrived,'" says Jesse Toprak, executive director of industry analysis at Edmunds.com Inc.

Still, Asian companies seem like a long shot to buy all of Chrysler. A Daimler executive and a banker close to the company confirm that Hyundai has also lined up to examine Chrysler's books, despite official denials from the Korean automaker. Hyundai is hungry to double North American sales, to 1 million vehicles by 2010. But several observers see a culture clash between Hyundai's often imperious, top-down management style and independence-minded Chrysler managers. "On paper it makes some sense, but these kinds of deals are not executed on paper. It comes down to people making them work," says Gerald C. Meyers, professor at the University of Michigan Business School.

Could a Chinese automaker snap up Chrysler? That would accelerate Chinese expansion plans by a full decade. Up to now, the Chinese have had to live with limited joint venture agreements, like one just inked by Chrysler and Chery to produce small cars for Chrysler worldwide. But Chinese companies probably still don't have the financial or political savvy to nail such a huge U.S. deal. ■

—With Gail Edmondson in Frankfurt

ODDS OF A SALE TO PRIVATE EQUITY
50%

GOLDEN PARACHUTES

WHEN SHAREHOLDERS PAY THE CEO'S TAX BILL

A backlash is building against payouts to cover taxes on huge severance packages

BY JANE SASSEEN

IT'S ONE OF THE EASIEST CEO perks to pick on: the so-called tax gross-up when a company is taken over. When SBC snatched up rival AT&T in late 2005, outgoing AT&T CEO David Dorman walked away with \$29 million in cash and other severance. To help cover Dorman's IRS bill, the board forked over \$11 million more.

Such payments are sure to be a hot-button issue this proxy season, with new rules that require companies to disclose the size of potential severance packages in the case of a merger or acquisition, including tax gross-ups.

They'll generate even more attention because, thanks to the complicated tax code, gross-up payments can easily double the severance. Some argue that they also let companies underplay what they've promised to executives. "To say we'll pay you \$10 million plus a gross-up—it really means we'll pay you \$20 million," says David S. Pottruck, ex-CEO of Charles Schwab & Co. and a member of the board compensation committee at Intel Corp., which does not offer the benefit. "It's a way of hiding the facts about what you're truly paying."

The little-known perk came to life in the merger-frenzied 1980s after Congress imposed a painful additional tax on executives who make windfalls by selling their companies and cashing out. To keep top executives happy—and help lure new talent—companies began agreeing to pick up the tax bill. According to a study of roughly 1,000 large U.S. companies by consulting firm Towers Perrin, only 10% had gross-



THE STAT

\$11 million

What AT&T gave Dorman to pay the taxes on his \$29 million severance

Data: AT&T

ups in 1987; today it's 77%. The exceptions tend to be fast-growing tech companies and industry giants, such as Intel and Johnson & Johnson, that haven't had to worry about a takeover.

Problem is, gross-ups are costly. Because of the tax code's many quirks, companies can end up paying millions to the IRS so executives can take home just a few hundred thousand more in severance. "It's an incredibly inefficient use of shareholders' money," says Paula Todd, a managing principal at Towers Perrin. "It's often the most costly part of the golden parachute."

What's more, few insiders understood

the true numbers involved. "In the past, most directors didn't know what gross-ups cost," says Lionel M. Allan, a former director of Catalyst Semiconductor at NetLogic Microsystems who now heads the Silicon Valley chapter of the National Association of Corporate Directors. "Very few drilled down into the numbers figure out how it all added up."

Gross-ups aren't inherently bad. Pay consultants note, for example, that tax bills are arbitrary. The 20% "excise tax," which is in addition to income tax, kicks in when severance totals more than three times executive's average income—including salary, bonus, and the gains on any exercised stock options—over the previous five years.

Since the tax came into law, it has become standard for a CEO to get three times salary and bonus in severance. Because any outstanding options and restricted stock automatically vest, the excise tax is almost always triggered, says Jannice L. Koors, a managing director at Pearl Meyer & Partners. But consultants note that CEOs who on paper are set to get the same severance could end up with dramatically different tax bills.

Why's that? Say two CEOs pocketed the same salary and bonus in the past five years but one cashed out twice as many options. That executive would have reported a much higher income to the IRS, less of the windfall would be hit by the excise tax. "A lot of directors felt the tax law got screwy results," says Todd. "They wanted to give executives the severance they intended, and took a gross-up to do it, that's what they do." It was especially easy to be generous with tax breaks since the acquirer's shareholders would eventually foot the bill, says Allan. "It was someone else's money."

Such attitudes are starting to disappear. Gross-ups create a "challenge reasonableness" that will be harder to justify, says Donald Perkins, retired chairman of retailer Jewel Cos., who has sat on the boards of AT&T, Corning, and Time Warner. "You'll see a lot fewer gross-ups in the future." Some boards are already limiting their obligations. The new contract for NASDAQ CEO Robert Greifeld includes a gross-up with limits if the cost of the payment far outstrips his benefit. That's bad news for Greifeld and Uncle Sam, good news for shareholders. ■

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THE NEW VALUE FRONTIER





SHAREHOLDER ACTIVISM

HOTTER SEATS THAN THEY BARGAINED FOR

Some hedge funds that pushed their way onto boards have activist's remorse

BY MATTHEW GOLDSTEIN

DAVID EINHORN DOESN'T make many bad bets. Last summer the 38-year-old hedge fund manager walked away with \$650,000 in the World Series of Poker, cash he promptly donated to charity. He has proven just as adroit at running his \$3 billion Greenlight Capital Inc., which engages in so-called activist investing. Over the years Einhorn has generated fat returns by taking positions in companies and then badgering management into making drastic changes to boost the stock price. Last year his firm booked a heady 25% gain.

The high-stakes brawler isn't immune to losses, however. Consider his disastrous experience with New Century Financial Corp., an Irvine (Calif.) lender that specializes in mortgages for people with shaky credit. Last year, after accumulating a 6.3% stake, Einhorn threatened management with a proxy battle, relenting only after clawing his way onto the company's board in March. So far all he has to show for the saber rattling is red ink. On Feb. 8 the stock plunged 36%, to a

four-year low, after New Century warned that it would report a fourth-quarter loss and restate some of its 2006 results. The stock fell more on Feb. 21 after subprime mortgage lender NovaStar Financial Inc. reported even worse earnings news. Shares of New Century, trading around 17.50, have been cut in half since Einhorn joined the board.

His experience underscores the risks of shareholder activism. Unlike other investors who might opt to minimize the pain by selling shares, Einhorn has his hands pretty much tied. His seat on the New Century board makes him a corporate insider, which restricts his ability to run for the exits when bad news hits. So Einhorn—along with Greenlight's investors—must stick around and hope New Century, which is now being hit with a wave of shareholder suits, turns things around.

To be sure, hedge funds are showing a

knack for boosting stock prices by heaving big dividends, share buybacks, or asset sales. A recent academic study found that, over the past five years, hedge fund agitators have outperformed the market. The wit: Atticus Capital, a \$14 billion hedge fund, is credited for forcing copper miner Phelps Dodge to sell itself to Freeport-McMoRan Copper & Gold in a \$26 billion deal that will deliver a 33% premium to Phelps shareholders.

TOO STICKY

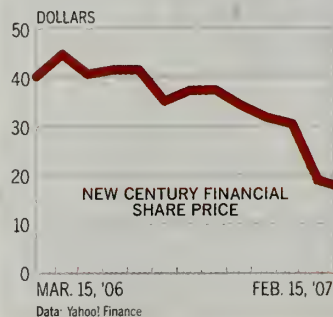
BUT THE RISKS FOR agitators increase the minute they land on a company board. Most hedge funds are short-term players that relish their ability to jump into and out of investments. Board relationships are sticky, says Damien Park, president and chief executive of Hedge Fund Solutions, a consultant that advises companies on how to work with activist funds. "Investors who join boards should be long-term-oriented," he says. "This includes the good, the bad, and the ugly times."

Perhaps the best-known instance of an activist getting burned was the proxy battle waged by Warren G. Lichtenstein for a seat on the board of BKF Capital Group, an investment management firm. In 2005, Lichtenstein, the manager of the \$1 billion hedge fund Steel Partners, won a board seat with the support of Carl Icahn (page 68) and other activist hedge fund managers. Lichtenstein planned to use the seat to wage a campaign to cut costs at the struggling investment firm, but the share price collapsed before that could happen. Trading around 20 when Lichtenstein joined the board, the stock was delisted from the New York Stock Exchange last year and now fetches about 3 on the unregulated Pink Sheets. A Lichtenstein spokesman declined to comment.

It's hard to know whether Einhorn regrets the New Century deal. A Greenlight spokeswoman says he won't comment on the matter.

He is being equally uncommunicative with his own investors. Those familiar with Greenlight say Einhorn can't discuss the fund's investments in New Century without running the risk of turning his fund investors into corporate insiders. New Century is keeping mum, too. ■

FROM BAD TO WORSE



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PORSCHE

MEXICO

SLIM'S BIG GIVEAWAY

As the government steps up its scrutiny, the billionaire is stepping up his philanthropy

BY GERI SMITH

WHAT DO YOU DO if you are Mexico's most powerful businessman and a lightning rod for criticism? You give away a lot more of your money. That's what Carlos Slim Helú plans to do—this year and probably for the rest of his life. The telecom, retail, and industrial billionaire certainly can afford it. His net worth, estimated at \$54 billion, has soared about 66% in the past year thanks to the performance of his companies on Mexico's booming *bolsa*. That means Slim, 67, may now be the world's richest man after Bill Gates.

Like any powerful industrialist nearing his twilight years, Slim wants to build a lasting legacy. Following the example of Gates and Warren Buffett, the Mexican tycoon thinks philanthropy is one way to make a difference, not only in Mexico but throughout Latin America. For the past 10

years, Slim's best-known charitable work was done through his telecom company's Telmex Foundation, whose \$1.2 billion endowment makes Telmex the region's largest corporate giver. But Slim is expanding the activities of his family charity, the Carso Foundation, after more than doubling the size of its endowment last year, to \$2.5 billion. "I'm not just giving away money. I'm channeling resources to try to solve [health and education] problems as quickly as possible," he told *BusinessWeek* in an interview at his office in a Mexico City mansion filled with antique books and baseball memorabilia.

Yet Slim may have reasons besides good-heartedness to throw open the philanthropic taps. Such a gesture could deflect pressure from new President Felipe Calderón as he launches a campaign to rein in some of the powerful companies that dominate telecommunications, cement, beer, tortillas, and other industries in Mexico in a bid to spur competition and growth.

Slim's empire, which

accounts for nearly half of the Mexican stock exchange's \$366 billion value, is an obvious target. Telmex, which is 49.1% owned by Slim and his family, controls 90% of Mexico's phone lines and charges among the highest fees in the world, says the Organisation for Economic Co-operation & Development. Rivals such as Spain's Telefónica Móviles complain that Slim's wireless giant, América Móvil, has thrown its weight around to grab 72% of wireless clients in Mexico. The government plans to take a harder look at several sectors that need more competition, including telecom, says Economy Minister Eduardo Sojo. "A country like Mexico, with such an unequal distribution of wealth, needs much more strict regulation to promote more competition," he notes. Slim skeptics argue that his charity is politically motivated. There's "a growing public consensus that Slim's attempts to block competition are hurting the Mexican economy," says Dennis Dresser, a political science professor at the Autonomous Technological Institute of Mexico in Mexico City. "He wants to ward off those criticisms."

Not everyone looks at Slim's initiative critically. Some think his charitable

Mexico has no estate tax, so there's less incentive to give than in the U.S.

SLIM New health, education, and sports programs are coming

forts could inspire other wealthy families in Latin America, where large-scale philanthropy isn't common. In Mexico, for example, there's no estate tax, so there's much less incentive to give than in the U.S. "It's great that the Carso Foundation and others are growing in Mexico because we need to encourage charitable giving," says Jorge V. Villalobos, president of the Mexican Center for Philanthropy.

After years of sitting in his former windowless basement office plotting his companies' growth, Slim insists he wants to devote nearly all his energies to philanthropy from now on. He has turned full operating control of his business empire over

his three sons—Carlos, 40; Marco Antonio, 38; and Patrick, 37. In coming weeks, Slim plans to announce the creation of three new charitable institutions that will focus on health care, recreation, and education in Mexico, where about half the population lives on less than \$2 a day. The new groups, to be run by the Carso Foundation, will fund everything from childhood vaccinations to cancer research to teacher training. Programs will be created to improve medical services in rural areas and encourage community sports activities. The foundation plans similar initiatives in the 14 Latin American countries where Slim's telecom companies operate. "We're serious about this," Slim says. "We will make sure enough resources are available for anything that needs to be done."

In its 10-year history, the Telmex Foundation has already pioneered groundbreaking programs for Mexico's poor. It has handed out 95,000 bicycles to impoverished children who live more than a two-hour walk from school and has given nearly 70,000 pairs of eyeglasses

to schoolchildren. It has paid the costs of more than 200,000 surgeries for low-income Mexicans and bailed out more than 50,000 first-time offenders jailed for petty crimes committed largely out of economic hardship. The Telmex Foundation has also awarded scholarships to more than 150,000 university students.

Up to now, the Carso Foundation, created 20 years ago, has kept a low profile. It quietly supported hospitals and a kidney-transplant center—Slim's wife, Soumaya, died of kidney disease in 1999. It established an archive of valuable Mexican historic documents and books worth an estimated \$300 million, plus a museum to which Slim donated his \$100 million art collection.

Now, with its bigger endowment and three new institutions, the foundation is expected to have a bigger impact. It re-

cently started refurbishing 1,000 public schools around the country and plans to help the government distribute low-cost laptops through the Massachusetts Institute of Technology Media Lab's One Laptop per Child program. It will help hundreds of thousands of teachers buy their own PCs and subsidize their Web connections.

Even this program could spark controversy since Telmex will sell the computers via monthly financing and provide Internet service partially paid by Carso. That has given rise to criticism that Slim's charitable giving is aimed at benefiting his own companies. "I don't care what people say," retorts Slim. "What's important is that as many people as possible get connected to the Internet so they can be more productive." No doubt he also hopes the government is listening. ■

ON MONOPOLY, PEMEX, AND KIDS

Billionaire Carlos Slim Helú recently sat down for a two-hour conversation with Mexico City Bureau Chief Geri Smith. Here are excerpts:

On whether he's a monopolist:

On the one hand, people in the government say I'm a monopolist, and on the other hand, people say the government is protecting me. Being a monopoly is different from being a dominant player. You're a monopoly if you're alone in the market. If there are five or six wireless competitors, you can't say we're a monopoly. There's always one dominant operator in a country. If people

are going to say América Móvil [Slim's cellular carrier] is a horrific monopoly in Mexico, then they're just stupid. If you charged more than others, you'd never get to be dominant. We've simply done a better job than some international competitors.

On what to do about Mexican state oil company Pemex, which pays virtually all its revenues to the government:

Pemex should have operational autonomy and should be taken out of the government's budget. With oil prices as high as they are now, it would have all the money it needed [to replace its shrinking reserves]. I don't think Pemex needs to be privatized.

On opportunities for infrastructure investments in Latin America:

Billions of dollars of investment are needed. Mexico alone needs to invest \$40 billion to \$50 billion a year, including the oil sector, ports, water, and housing.

On whether Mexico should tax capital gains on stock investments:

I personally would not be averse to [a capital-gains tax].

On his sons' role in his businesses:

When you leave your children a company, you are leaving them a big responsibility and a commitment. You don't want to leave them money, you want to leave them with a commitment.



FREE BIKES Some 95,000 have gone to children who live far from school

TAKEOVERS

GOING PUBLIC, CHINESE STYLE

To get listed overseas, companies are getting U.S.-traded outfits to buy them

BY BRUCE EINHORN AND
FREDERIK BALFOUR

BIG-TICKET IPOs IN NEW York and Hong Kong for Chinese banks and insurance companies make headlines. But in recent years another class of Chinese company has been quietly tapping the international capital markets. Enterprises that don't have the heft or profits for a splashy initial public offering are finding they can get a coveted overseas listing through a reverse merger.

Here's how it works. The Chinese business is typically acquired by a U.S. shell company that is worthless, except for one thing: It's publicly traded. The American board then resigns, the Chinese board takes over, changes the company's name, and issues new stock to hedge funds and other new investors, raising millions of dollars in fresh capital. One example: Sinovac Biotech Ltd., a respected Beijing-based maker of vaccines, executed a reverse merger in 2003 and subsequently raised \$12 million.

For more and more Chinese companies, a reverse merger is faster and less onerous than an IPO. Sometimes the process takes as little as a few months, says Peter D. Zhou, managing director of American Union Securities Inc., a New York firm that has helped broker 10 such deals since 2005 and is currently working on another nine. One is the pending takeover by Carson City (Nev.)-based Ticketcart Inc., a defunct online retailer of printer cartridges, of Tieli Xiaoxing-anlin Frog Breeding Co., which markets nutritional supplements made from Chinese forest frogs. All told, some



150 Chinese companies have taken the reverse-merger route since 2005. "The Chinese are realizing that there's a lot of money here," says Zhou.

Many in the financial world aren't happy about the popularity of these takeovers. Something few Chinese executives consider is that Americans generally shun such shells, as they typically trade over the counter, says Neil A. Torpey, a Hong Kong-based partner with law firm Paul, Hastings, Janofsky & Walker. "Nobody follows them, there's no market in the shares," he says. "So after having gone through a lot of time and ex-

pense and effort, the underlying purpose aren't realized."

So why do Chinese companies both er? One reason is simple: They have few other options. Small companies in the country's rust belt or in industries that aren't sexy are unlikely to draw the interest of the venture capital and private equity investors swarming over China. Plus there's a two-year wait for a listing on the booming Shanghai or Shenzhen stock exchanges. "If a U.S. financier says 'I can get you public in two months,' that's a pretty good pitch," says one American hedge-fund manager who wants to remain anonymous because he has invested in a Chinese company that executed a reverse merger.

Another reason Chinese companies favor these deals is that there's less interference from investors. Reverse mergers are usually followed up with a private placement. The hedge funds that typically buy these shares are content to allow management to continue operating unfettered, whereas private-equity outfits would typically demand greater say in decision making along with board seats.

Some Chinese companies involved in such deals have, however, found themselves in legal trouble. Fertilizer maker Bodise Biotech Inc. and now-defunct China Energy Savings Technology Inc. face shareholder class actions alleging improper disclosure.

Still, investors argue there's nothing fundamentally disreputable about reverse mergers. Some well-known Chinese companies such as Sinovac and Shenzhen-based battery maker China BAK Battery Inc., have graduated from the OTC market to the American Stock Exchange or NASDAQ. "As we see more of them grow to multimillion market cap, there is more research, more liquidity in the stocks," says Mark Fleishhauer, Hong Kong-based portfolio manager at Jayhawk Capital Management, a hedge fund that has invested in 11 reverse mergers in 2006, including BAK Battery.

But even fans of the reverse-merger option recognize its shortcomings. With estimated annual revenues of \$15.4 million in 2006, Sinovac would probably need to take the reverse-merger route today. Says Helen G. Yang, Sinovac's international business manager: "If I wanted to list now, an IPO would be a better choice." ■

The process can take as little as a few months and is less onerous than an IPO



AIRCRAFT

AIRBUS REVS UP THE ENGINES

To generate badly needed cash, it's boosting output of its popular A320 to record levels

BY CAROL MATLACK

FOR MONTHS NOW, AIRBUS has seemed paralyzed. The launch of its A380 megajet has fallen two years behind schedule, while multiple redesigns of its A350 widebody have delayed that plane's launch until 2013. On Feb. 19 a clash between the French and German governments over the aircraft maker's future forced the postponement of a long-awaited restructuring. As these setbacks dominate the news about Airbus, the company has embarked on an ambitious and risky strategy to pull itself together. The European plane maker will need an estimated \$15 billion to build the A350, even as the A380's woes slash billions from the bottom line. To generate that badly needed cash, it is boosting production of its single-aisle A320 aircraft to record levels while wringing efficiencies from its factories and suppliers as never before. Popular with discount airlines and other carriers on short-haul routes, the

A320 models sell for as little as \$55 million, about one-third the catalog price of most widebodies. And while A320s yield razor-thin margins, some 2,019 are on order by airlines, making them a rich source of cash. Already, an average 32 A320s are rolling off German and French assembly lines each month, more than any commercial aircraft in history. By the end of 2008, monthly output is set to rise to 36, then to 40 after Airbus opens a new assembly line in China in 2009. By comparison, Boeing Co.'s production of its competing 737 models is about 25 planes a month. The Airbus ramp-up "is a huge challenge for us," says Tom Williams, executive vice-president in charge of aircraft production. "We are really stretching."

Stretching too far could be dangerous. In the mid-1990s, Boeing's assembly lines suffered a near-meltdown when the company

PRODUCTION TUNE-UP Airbus is using techniques from Wal-Mart and the auto industry

tried to speed up production of several models simultaneously. Mindful that it could suffer a similar fate, Airbus has studied that debacle in detail. A key finding: Boeing didn't work closely enough with suppliers to ensure a smooth flow of parts. So for more than a year, Airbus engineers have been meeting regularly with subcontractors, reviewing everything from the capacity of their tooling equipment to their procurement of titanium and other raw materials. "One part of the supply chain failing endangers the whole chain," says Alain Flourens, the A320 program manager.

Airbus' drive to tune up production is evident at its A320 factory near Hamburg, Germany. In a cost-saving method borrowed from Wal-Mart Stores Inc. and other discount retailers, it has leaned on suppliers for just-in-time delivery of components. And Airbus suppliers now deliver parts in prepackaged trays loaded onto carts resembling chests of drawers, a technique patterned after the auto industry. The carts are rolled from the loading dock directly to the assembly line, so workers get everything they need without leaving their stations. "No one would have thought we'd be able to work this quickly," says Susanne von Arciszewski, supervisor of an assembly line where efficiency has nearly doubled in the past two years.

Major Airbus suppliers are scrambling to keep pace. For example, Messier-Bugatti, which builds aircraft wheels and brakes, recently broke ground for a factory in Kentucky to help meet its growing Airbus order book. But such expansion creates cascading demands that can tax the limits of other parts makers. "There are lots of small suppliers where Airbus is a customer, we are a customer, and some other suppliers of Airbus are customers,

and we are all going to increase our requirements at the same time," says Dominique Hédon, executive vice-president for strategy and development at Messier-Bugatti's Paris-based parent, Safran Groupe. Airbus has to avoid any weak links in the supply chain—or the A320 could join the company's list of troubled aircraft programs. ■

—With Stanley Holmes in Seattle

THE STAT

2,019

Airbus A320 planes on order, compared with 1,639 orders for Boeing's 737

Data: Company reports

WHY TO AFRAID NUMB

It's overtaking Detroit—with trepidation. Now, the carmaker is rely

ASK CONSUMERS WHY TOYOTA may soon be the largest automaker in the world, and they will point to the Camry. Or the Prius. Or the RAV4. (It's the cars, stupid.) Ask manufacturing geeks, and they'll tell you it's about just-in-time production and a maniacal focus on constant improvement. (It's the engineering, dummy.)

But there's another drama behind the carmaker's tire-squealing momentum. It's a story that might be called: How Toyota is winning the hearts and minds of America.

With a deft combination of marketing, public relations, and lobbying, Toyota has done a remarkable job over the past 20 years of selling itself as an American company. That drives the Big Three to distraction. Here's Chrysler communications chief Jason Vines: "The thing I resent is Toyota wrapping themselves in the American flag," he says. "We still employ more people and contribute more to the economy."

Who cares what Detroit thinks? Well, strange as it



TOYOTA IS OF BEING R ONE

ever-savvier PR to avoid the U.S. backlash it dreads. **BY DAVID WELCH**



sounds, Toyota does. Its executives may privately relish victory at the expense of General Motors, Ford, and Chrysler, but here's the truth: Toyota is afraid to be No. 1—or at least what that implies. And not just because one of its slogans is “Run scared.” It's because the extra scrutiny could undo much of the hard work of the past 20 years. “We constantly need to think about the potential backlash against us,” Toyota CEO Katsuaki Watanabe tells *BusinessWeek* in an exclusive interview. “It's very important for our company and products to earn citizenship in the U.S. We need to make sure we are accepted.”

A 17.4% retail market share should signal acceptance. But Toyota is not admired from sea to shining sea. Yes, the company has won the coasts.

TUNDRA
A full-size pickup may bolster Toyota's American image

But one-third of car buyers are biased against imports, says Harris Interactive. And most of those Ford- and Chevy-loving holdouts live in the Midwest

PHOTOGRAPH BY RON KIMBALL; (LICENSE PLATE) DAVID RUDES/BW



SAN ANTONIO, 2007
Toyota is working extra hard to be a good citizen in Texas

and Texas. In those precincts, Toyota still has a lot of persuading to do. Which explains why it launched the full-size Tundra pickup—a red state vehicle from its aggressive hood to its brawny haunches—and is building it in San Antonio.

Here's the thing: The Tundra amounts to an assault on the last redoubt of Big Three profits. But Toyota doesn't want to be seen as the one that pushes Detroit over the edge. So to prevent a backlash, the company is amping up the charm—launching literacy programs in San Antonio, vowing to share technology with Ford, and pouring money into lobbying, more than doubling since 2002 the amount it spends each year, to \$5.1 million. Says Jim San Fillippo, an analyst with Automotive Marketing Consultants Inc.: “Toyota is the best at going native.”

In the early '80s, Toyota sold nine models and had 6% of the market. But the company was winning converts with fuel-efficient, reasonably priced cars like the Toyota Corolla. Detroit, meanwhile, was beginning to endure the agonies that continue to this day. Japan was ascendant, and xenophobia was in full cry.

Toyota scion Shoichiro Toyoda needed to boost sales in the U.S. but feared angering consumers and Washington pols. So in 1984, he hired a Ford PR guy named James Olson. Dr. Toyoda summoned Olson to Nagoya and exhorted him to undertake *genchi genbutsu* (“go and see”).

What Olson found wasn't terribly surprising: With just one U.S. factory—and a joint venture with GM, at that—Toyota was widely viewed as a foreign interloper. At Olson's urging, the company began playing to local sentiment. In 1986, Toyota announced a new plant in Kentucky. In the same year, it rehired many of the 3,000 laid-off GM workers to staff the joint-

venture plant in Fremont, Calif. George Nano ran the United Auto Workers local at the time, and recalls company executive and plant bosses eating in the same cafeteria as the rank and file. That never happened when GM was running the factory.

That same year, a Roy Howard comedy called *Gung Ho* appeared; it contrasted the American and Japanese work ethics at a car plant operated by an Asian company called Assan Motors. (Toyota later used the film as an example of how not to manage Americans.)

Toyota escalated the PR offensive. In 1991, it started funding the National Center for Family Literacy and other do-good works. It was textbook corporate philanthropy. But Toyota also did something few American corporations would consider: dispatching efficiency gurus to companies like Viking Range Corp. and Boeing Co. and to local hospitals. All this was an effort to help make these places work smarter—and build goodwill.

Beating the Tax

But even the savviest gestures were of little use against rising trade tensions. In 1993, Big Three executives won a sit-down with President Bill Clinton. Why, they wanted to know, could the likes of Toyota flood the U.S. with cars, while domestic automakers were mostly locked out of Japan? “It was clear Detroit was having trouble,” recalls Mickey Kantor, who was then Commerce Secretary. So Clinton threatened a 100% tax on luxury car imports.

That would have mauled Toyota's five-year-old Lexus brand.

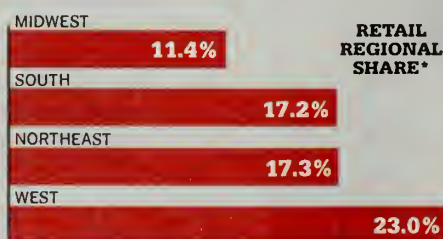
It was time for some Kabuki. In those days, Toyota had no game in Washington. But Toyoda was a friend of Walter F. Mondale, then ambassador to Japan. They made a deal: Toyota would build three plants in the U.S. Clinton nixed the tax. It seemed like a concession at the time. But one Toyota executive says the company planned to open the factories all along.

Detroit's lobbying had come naught. Toyota was about to establish a beachhead from which it would double U.S. market share over the next decade. With each new plant, Toyota won friends in Congress, where it began building clout.

Toyota executives have a name l

WHERE TOYOTA'S HOT—OR NOT

It has a 17.4% share nationally, but isn't admired from sea to shining sea



*EXCLUDES FLEET SALES

Data: R. L. Polk & Co.

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Outlook

A special excerpt from the journal of high-performance business

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High performance. Delivered.



Leadership

How to create a culture of high performance

The particular kind of culture that sustains high performance depends on commitment at the highest levels of the organization. Accenture's research has identified the five key mindsets that underpin this performance anatomy and what leaders need to do to develop them.



This article is one in a series excerpted from *Outlook*, our journal of high-performance business. The content derives from our groundbreaking research, initiated in 2003, to empirically determine the characteristics that enable high-performance businesses to consistently outperform their peers over the long term. Thus far, over 6,000 companies have been studied, including more than 500 that meet our criteria as high performers.

At the heart of today's most enduring and successful companies is something we call a "performance anatomy," one of the three building blocks of high performance identified by our ongoing research program. Although performance anatomy is, like culture, an often elusive concept, it is something senior executives can and must shape, rather than simply allow it to evolve on its own. Part of the leadership effort involved in creating a high-performance anatomy is, quite literally, changing the way people think.

Put another way, the successful leader must get everyone in the company to share the same specific mindsets—the way employees see the organization, its history, goals and values. Over the course of a two-year investigation, we determined that to improve business performance, five mindsets matter most. Our research has also found that each mindset is associated with a specific set of leadership actions that help propel a company toward high performance.

Mindset 1: Maintaining the right balance between market-making and disciplined execution

Leadership action Avoid false trade-offs and commit to a dual focus on the present and the future.

Companies can sometimes get stuck in an "either-or" trap: either managing for today or investing in the future. Leaders of high-performance businesses, by contrast, take a "both-and" approach—surrounding themselves with talented individuals who excel in both short- and long-term disciplines. While insisting on outstanding returns from today's operations (as demanded by investors), they also invest heavily in what it will take to be a game-changing innovator in the future.

Consider Harrah's Entertainment, which grew from 17 casinos and 36,000 employees to about 40 casinos and 85,000 employees between 1999 and 2005. During this ongoing period of aggressive growth, refining and preserving the company's unique culture of high performance has been one of CEO Gary Loveman's biggest challenges. At the same time, Loveman has made it clear that flawlessly executing today's strategy is a paramount concern. Harrah's managers are expected to rigorously



analyze the business and to justify their plans and decisions on the basis of their ability to add value.

Mindset 2: Obsessively identifying and multiplying talent

Leadership action: Invest a disproportionate amount of time in recruiting and developing people.

A knowledge-age business has little hope of achieving high performance unless its top executives lead the charge to acquire, develop and manage the performance of its employees. Effective leaders must become obsessive talent scouts. They need to get personally involved in the search for the best people, both inside and outside the organization—and then help develop that talent.

This clear commitment to finding, growing and retaining talent is particularly important for BMW, whose lifeblood is innovation. In fact, the carmaker routinely plans for professions that will be needed in the future. As Chairman Norbert Reithofer explains: “Today, we need to know as precisely as possible what skills will be necessary tomorrow. In order to successfully develop, produce and market a new vehicle, we must shape and

master innovation.” BMW’s approach to recruiting and people development—expressed in the chairman’s maxim, “It takes the best to make the best”—reflects a powerful talent-multiplier mindset.

Mindset 3: Using a selective scorecard to measure business performance

Leadership action: Rely on a simple, memorable way of measuring success and use every occasion to share those success stories throughout the organization.

Executives today are at risk of drowning in an ocean of technology-generated data. Rather than tuning out, executives of high-performance businesses respond to data overload by making the company’s business model as simple and as transparent as possible, then determining which measures—especially workforce-related measures—are needed to keep the business on track. By constantly emphasizing both model and measures, a selective-scorecard mindset is embedded in the organization.

A key measure the top team of Best Buy uses to track business performance for its nearly 1,000 stores is

Advertisement

employee engagement. Generated by survey, employee engagement scores indicate workers' commitment to the job and to the company. Best Buy uses the scores to analyze how local management variations relate to the stores' financial performance. In an internal study, analysts found that the store with the highest engagement score ranked in the top 10 percent of Best Buy stores as measured by P&L budget variance; the store with the lowest score ranked in the bottom 10 percent. The company's leaders make sure that store managers are aware of the importance of these numbers to Best Buy's continuing high performance.

Mindset 4: Recognizing technology as a strategic asset

Leadership action: Invest in technologies that will demonstrably lead to better business performance

Executives often feel pressure to invest in the "latest and greatest" information technologies, whether or not the investment is justified by actual business needs. By contrast, high-performance businesses usually spend less on information technology than their competitors do—but their investments always have strategic implications. These companies also push their technology leaders to think like business strategists and operators. As a result, an organizational mindset in which IT is seen as a strategic asset takes hold.

At some of the best companies, the use of IT as a strategic asset is so deeply embedded as to be unconscious. UPS, for example, uses business cases and post-implementation measurements to monitor the returns of a billion-dollar IT budget. When the company decided to invest \$600 million in its package flow software, the decision was explicitly linked to a key business goal. The decision emanated, according to CIO David Barnes, from the leadership's strategy to achieve "one-to-one customer relationships, while maintaining an IT infrastructure with 'dial-tone reliability.' "

Mindset 5: Emphasizing continuous renewal

Leadership action: Ensure that the organization understands what to preserve from its current ways of doing business and what to jettison.

Organizational momentum encourages the continuation of current practices and habits, particularly in successful organizations. The downside can be getting into a rut, leaving the organization vulnerable to competitors that will outmaneuver, out-innovate and out-adapt. Effective leaders therefore reinforce a mindset of continuous renewal. They must ensure the organization is developing increased market sensitivity and good judgment concerning what should and should not be sustained and what should be renewed.

For example, when Mayo Shattuck became CEO of Constellation Energy in late 2001, he had to right a ship that was listing badly. The industry was being buffeted by the shockwaves of the Enron scandal, and Shattuck knew it was essential to remind employees of the company's proud heritage and history of innovation. Using an extensive array of artifacts from the company's past, he created a veritable museum on each floor of Constellation's headquarters—reminders to all that Constellation had never flinched from taking on major (but calculated) risks or from embracing necessary change.

A company's anatomy can be a powerful force for achieving high performance. But the steady hand of leadership must function successfully across a range of conditions, from periods of prosperity to those of turbulence in the industry or economy. When senior leaders, guided by core values, create, shape and maintain the five mindsets that constitute a performance anatomy—and that ultimately underpin high performance—they help their organizations establish the practices that lead to superior business results. An important first step on that path is to master the critical leadership actions that develop and encourage those mindsets.

To read this and other *Outlook* articles on high performance in full, and to review findings of our High Performance Business research, please visit accenture.com/research-articles


High performance. Delivered.

Few automakers have a better environmental pedigree than Toyota. And no car has more green cred than the Prius

politicians they deem friendly: the Toyota Caucus. These are people who represent the states—California, Indiana, Kentucky, Texas, and West Virginia—where Toyota builds cars and trucks. One of the club's charter members, if you will, is Jay Rockefeller, the junior Democratic senator from West Virginia. The Rockefellers and the Toyodas go way back; Jay studied in Japan and speaks the language.

While most states set up their lobbying offices in Tokyo, West Virginia's headquarters is in Nagoya, near Toyota's headquarters. Few have worked harder than Rockefeller to persuade Toyota to build a plant in his state. In 1996, not long after the Clinton luxury tax was quashed, the state got a \$400 million engine plant in Buffalo, W. Va. Today 1,000 people work there, and the investment has swelled to \$1 billion.

In 2001 Toyota gave \$1 million to the Blanchette Rockefeller Neurosciences Institute at West Virginia University,



medical research center named after the senator's mother. About the same time, Toyota and Honda Motor Co. began backing a push for tax credits for consumers who bought hybrids. The Prius was selling at a premium over conventional cars and Toyota wanted a marketing tailwind. Four years later, Congress passed a credit for up to \$3,150. One of the bill's sponsors was Rockefeller. He denies Toyota directly lobbied him over the hybrid sweetener. But Toyota did talk to his staff about the bill, and Rockefeller acknowledges that "maybe I learned something from Toyota" about automotive technology.

Few automakers have a more unassailable environmental pedigree than Toyota (its closest rival is Honda). And no car better represents the company's green cred than the Prius. When Toyota tell it, the hybrid was simply so trendy and well-engineered it practically sold itself. There's more to the story than that.

Just before Toyota was about to launch the Prius in 1999, it called Dan Becker, director of global warming initiatives at the Sierra Club. The company wanted the group's seal of approval for the Prius. Becker persuaded his superiors to create an award for the best hybrid technology. The idea was controver-

CENTER LINE, MICH., 1992
Attitudes have shifted drastically in 15 years

sial, and Becker says some Sierra Clubbers called him a "whore for the auto industry." In the end, Honda's hybrid Insight won the Sierra Club Award for Excellence in Environmental Engineering; the Prius won the following year.

The Toyota-Sierra Club dance didn't end there. In 2001, the group borrowed a half-dozen Priuses and drove them from Maine to Florida, stopping in cities along the way and letting people drive them. The group also held a cross-country trek along Route 66, hitting towns and cities from Chicago to Los Angeles. The drive-and-tell seemed to work wonders. Says Becker: "Someone at Toyota told me that a phenomenal percentage of people who tested the car bought one." By 2004, Toyota had passed Honda and had the greenest image. "They just blew past us in the surveys," says John German, manager for environment and energy analysis for American Honda Motor Co. "They're in first place now."

Meanwhile Toyota turned to its point man in celebrityville: Mike Sullivan, who owns Toyota of Hollywood. Sullivan got hold of 26 Priuses and took them to the 2003 Oscars. Before long, such stars as Cameron Diaz and Leonardo DiCaprio were being photographed ("Look, we're so green!") with their Priuses. "It became the cool thing to do," says Sullivan. Now, every November, Toyota sponsors the annual Environmental Media Assn. Awards in Los Angeles. TV shows and movies that feature environmental causes get a trophy. Celebrities enter the ceremony along a green carpet, Sullivan is a sponsor, and the Toyota image is omnipresent.

Heading for the Heartland

Today, Toyota is the most respected car company in America. And yet to become the biggest-selling carmaker in the U.S., it needs to make serious inroads into the heartland, where imports are often considered un-American and the pickup truck rules the road. Nationally, Toyota has a 17.4% retail share. But once you break down the numbers by region, a more nuanced picture emerges. In the Midwest Toyota has just 11%, according to R.L. Polk & Co., which tracks car registrations. And in Texas, Toyota has a meager 5% share of the pickup market. Mike Foster will proudly tell you why. A 50-year-old homebuilder from San Antonio, he has 195,000 miles on his Ford F-150. "I've never owned a Japanese car of any kind," says Foster. "I believe in supporting American jobs. I know Toyota creates jobs here, but the money goes back to Japan."

Knowing what it's up against, Toyota has rolled out a \$300 million marketing campaign for the Tundra. It is sponsoring livestock shows, bass-fishing tournaments, and made its NASCAR debut on Feb. 18. Toyota has a campaign, internally dubbed "Prove It," involving free test drives at Bass Pro Shops, a national chain of outdoor sports shops, and 84 Lumber stores. Its TV ads feature a narrator, complete with Texas drawl, promoting the Tundra as "the all-new, built-in-America, Toyota truck."

Meanwhile, Toyota is out winning hearts and minds in San Antonio's south side, where the factory is. In late January, the company brought its 16-year-old literacy program to Sky Harbor Elementary School. There, in the Toyota Family Literacy Program Room, Hispanic families are learning to read and write English. "The south side had not been receiving much attention," says Jada Pitman, who runs the program. "But now

The Corporation

you have homes and roads being built to accommodate Toyota. Their presence is really being felt in the community.”

In Washington, too. Toyota's chief lobbyist, Josephine Cooper, who formerly told Detroit's story on the Hill, has been busy. At her behest, Toyota has amped up its advertising efforts inside the Beltway. Its latest campaign has been running on TV and in such publications as *Roll Call*, *Washingtonian*, *Congress Daily*, and *Congressional Quarterly*. It reminds politicians that Toyota has spent \$17 billion over 20 years on new plants and that it directly employs 38,000 Americans.

Five decades after selling its first cars in America, Toyota still feels the need to apologize for—or at least justify—its success. Now, the company's relentless expansion is bring-

ing unwanted attention. A series of recalls has hurt Toyota's reputation for quality. Environmentalists complain that the automaker's move into the big-truck market makes it look more and more like the Big Three all the time. And James E. Press, who runs the North American operations, acknowledges that Toyota is under greater scrutiny now that it's closing in on GM as the world's No. 1 automaker. Yet among Toyota's U.S. leaders, at least, there is the feeling that the humility has gone far enough. During a recent meeting at the North American headquarters in Torrance, Calif., executives agreed Toyota should stop worrying about being loved and learn to accept industry leadership. Are you listening, Watanabe-san? ■

—With Ian Rowley and David Kiley

MANAGING SUCCESS

Fighting To Stay Humble

BY IAN ROWLEY

Katsuaki Watanabe lifted his water glass and looked at it, slowly, carefully. “If you stare at this long enough, you can see many cost problems,”

he said. “It's such a complicated design. A paper cup would cost a fraction of this.”

That episode, in July, 2005, was classic Watanabe. The 64-year-old president of Toyota is a reserved man, cut from traditional salaryman cloth. Coaxing details from him is like squeezing water from a stone. Then Watanabe will suddenly fix on a question or an object that seizes his interest and examine it with intensity.

That ability to focus explains how Watanabe got to the top of Toyota Motor Corp. in June, 2005. He has no international experience, and his English is limited. He doesn't have Renault-Nissan CEO Carlos Ghosn's presence on the podium. His manner is self-effacing in the extreme. Some have wondered if Watanabe was a stopgap, keeping the seat warm for the 50-year-old Akio Toyoda.

When Watanabe does talk, you realize why he was chosen: He is obsessed with keeping Toyota safe from its own success. “To be satisfied with becoming the top runner, and to become arrogant, is the path we must be most fearful of,” he says during a rare one-on-one at Toyota City headquarters.



In his long career, Watanabe has run Toyota's staff canteens, overseen the company's Motomachi plant, and managed the corporate planning division. But it was as chief architect of Toyota's CCC21 cost-cutting plan that Watanabe embodied the company's fanatic drive to stave off complacency. The goal was to slash prices on all key components for new models by 30%. Getting there required a reinvention of Toyota's relationship with suppliers and a reexamination of the cost of every item, however mundane, from ball bearings to turn signals. The program saved Toyota \$10 billion.

The Toyota boss is now leading a second effort, Value Innovation Activity, to trim costs even more: Toyota will overhaul the way it designs cars to find savings early in a model's evolution. He also vows to make Toyota's next class of hybrids much more affordable: “We're aiming at cutting in half both the size and cost of the third-generation hybrids.”

Watanabe is seizing on every pretext to create an atmosphere of emergency.

TAKING HEAT

Watanabe answering questions during last summer's spate of product recalls

Last summer a string of recalls were denting Toyota's reputation for quality. Taking responsibility, Watanabe made several public apologies, describing the problems as a “crisis.” He then delayed new

car launches, including a revamped Corolla in the U.S., to ensure that quality was up to snuff.

Yet the numerous apologies were arguably as much a warning to Toyota's rank and file as a means of reassuring customers. “Before I met Mr. Watanabe, I wasn't so impressed. But the thing I found with him is that actually he is very tenacious,” says Tatsuo Yoshida, an analyst at UBS in Tokyo. “Toyota has used the quality issue to shake up the whole organization—subsidiaries and suppliers included.”

That shakeup gives Watanabe a fleeting feeling of satisfaction. “There's been improvement,” he says. “‘Big-company disease’ has been receding.” But then the self-congratulation is over. “There are so many challenges we need to address,” he says. “Problems must be made visible.”

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Customer Service Champs

BW's first-ever ranking of 25 client-pleasing brands included JetBlue, until it got stuck on the runway

BY JENA MCGREGOR

PHOTOGRAPHS BY CHIP SIMONS

BOB EMIG WAS FLYING HOME FROM St. Louis on Southwest Airlines this past December when an all-too-familiar travel nightmare began to unfold. After his airplane backed away from the gate, he and his fellow passengers were told the plane would need to be de-iced. When the aircraft was ready to fly two and a half hours later, the pilot had reached the hour limit set by the Federal Aviation Administration, and a new pilot was required. By that time, the plane had to be de-iced again. Five hours after the scheduled departure time, Emig's flight was finally ready for takeoff.

A customer service disaster, right? Not to hear Emig tell it. The pilot walked the aisles, answering questions and offering constant updates. Flight attendants, who Emig says "really seemed like they cared," kept up with the news on connecting flights. And within a couple of days of arriving home, Emig, who travels frequently, received a letter from Southwest that included two free round-trip ticket vouchers. "I could not believe they acknowledged the situation and apologized," says Emig. "Then they gave me a gift, for all intents and purposes, to make up for the time spent sitting on the runway."

Emig's "gift" from the airline was not the result of an unusually kind customer service agent who took pity on his plight. Nor was it a scramble to make amends after a disastrous operational fiasco, as JetBlue Airways Corp. experienced recently—leading us, after much debate, to remove it from our first customer service ranking (see page 58). Rather, it was



15 **CABELA'S**

CUSTOMERS GET A CALL of the wild each time they visit a store and see museum-quality dioramas with stuffed animals. Salespeople are encouraged to borrow equipment and then rev



standard procedure for Southwest Airlines, which almost six years ago created a new high-level job that oversees all proactive customer communications with customers. Fred Taylor, who was plucked from the field by President Colleen C. Barrett to fill the role in 2001, coordinates information that's sent to all frontline reps in the event of major flight disruptions. But he's also charged with sending out letters, and in many cases flight vouchers, to customers caught in major storms, air traffic snarls, or other travel messes—even those beyond Southwest's control—that would fry the nerves of a seasoned traveler. "It's not something we had to do," says Taylor. "It's just something we feel our customers deserve."

As Southwest recognizes, providing great customer service is much more than just a job for the front lines or the call centers. It takes coordination from the top, bringing together people, management, technology, and processes to put customers' needs first. That's true today more than ever. Technology is leveling the barriers between alpha companies and also-rans, making great customer service one of the few ways companies can distinguish themselves. Retail, online, and phone shopping channels are expanding, increasingly prompting customers to demand a seamless—and painless—experience. Refining time-tested concepts and coming up with cutting-edge ideas is critical for managing rank-and-file workers and measuring what customers think.

In *BusinessWeek's* first-ever ranking of the best providers of customer service, we set out to find the service champions, but also to dig into the techniques, strategies, and tools they use to make the customer king. To launch the process, we created a list based largely on brands in J.D. Power & Associates' database. In addition, we polled 3,000 of our readers, generating a pool of names most associated with treating customers well. We then asked J.D. Power, which, like *BusinessWeek*, is owned by The McGraw-Hill Companies, to survey customers about the brands that were nominated by readers but not already in its database. (For a full explanation of our methodology, see page 64.)

THE RESULTING LIST HAS ITS SHARE OF service legends—our No. 1 company, insurance provider USAA, has long been hailed for the way it treats its predominantly military customers and their families. Most of the names fell into one of three camps. There are industry disrupters, such as No. 14 Washington Mutual Inc., that offer a customer-friendly alternative in fields long plagued by poor service. Many are privately held or family-run, such as regional supermarket Publix Super Markets Inc., No. 19 on our list, and view great customer service as a founding, fundamental principle. Finally, there's a sprinkling of luxury brands, such as No. 7 Lexus, for which attentive, personal service is just part of the price of entry.

Despite their differences, most of the names on our list share a few important traits. They emphasize employee loyalty as much as customer loyalty, keeping their people happy with generous benefits and perks. Since 1984, No. 5 Wegmans has given away \$59 million in scholarships to 19,000 employees. And senior management logs hours on the front lines, listening in on phones in the call center or working by staffers' sides. At No. 15 Cabela's Inc., for instance, Vice-Chairman James W. Cabela spends hours each morning reading through the retailer's customer comments, and hand-delivering them to each

The Customer Service El

RANK	BRAND/INDUSTRY	PROCESS GRADE	PEOPLE GRADE
1	USAA Insurance	A+	A+
2	Four Seasons Hotels Hotels	A+	A+
3	Cadillac Auto	A+	A+
4	Nordstrom Retail	A	A-
5	Wegmans Food Markets Supermarkets	A-	A
6	Edward Jones Brokerage	A-	A
7	Lexus Auto	A+	A+
8	UPS Shipping	A	B+
9	Enterprise Rent-A-Car Rental Car	A-	A-
10	Starbucks Restaurant	B+	B+
11	Ritz-Carlton Hotels	A+	A+
12	Amica Insurance Insurance	A+	A+
13	Southwest Airlines Airlines	B	B
14	Washington Mutual Banking	B	B-
15	Cabela's Retail	A-	A-
16	Raymond James Financial Brokerage	B+	A
17	Porsche Auto	A+	A+
18	Apple Electronics	C-	B+
19	Publix Super Markets Supermarkets	A-	B+
20	Hertz Rental Car	B+	B
21	FedEx Shipping	B+	B
22	JW Marriott Hotels Hotels	A+	A
23	T-Mobile Wireless	C	C
24	Buick Auto	A+	A+
25	Lincoln Auto	A+	A+

*The Service Index is composed of a weighting of J.D. Power's scores for "people" and "process," plus a

gh innovations in technology, employee training, and customer-centered strategies, these service leaders don't just meet
er needs but anticipate and exceed them. For a full explanation of how we chose companies and brands, see p. 64.

THE BEST

cky enough to be customers (USAA's auto and home insurance is only open to military members and their families) get service from reps with great
including 2006 bonuses of 16.5%. Last year, USAA added a tool in its call centers that tracks frontline suggestions for customer-friendly ideas.

oyee—whether a housekeeper or a bellhop—gets a job before passing four interviews. The luxury chain knows that customer relationship management
it more than software database programs. Each hotel employs a "guest historian" charged with tracking guest preferences.

dealers have long been committed, like those of rival Lexus, to insuring customers have another car while theirs is in the shop. New improvements
n early-warning system for mechanical problems built into the OnStar telematics system, which is standard in all Cadillacs.

ordstrom on a service list is like seeing 3M on a list about innovation: The brands are practically synonymous with the topic. Still, they keep improving.
salespeople will be able to view a single database of the company's inventory to help customers find an item online that's missing in the stores.

lge-based service" is how Wegmans describes its approach. But offering expert help requires more available people. So Wegmans reorganized its back-
operations, moving some work off site. Associates, no longer tied to counters or stockrooms, are trained to aid shoppers on the floor.

e branch offices in the U.S. than Starbucks has cafés, Edward Jones meets customer needs by staying close to its customers—literally. In most cases, a
ancial adviser and one administrator work in each branch. Although cost-inefficient, advisers say the intimate size helps foster personal relationships.

aker is famous for going the extra mile. When Lexus recalled the RX330 last year, it gave inconvenienced customers an iPod nano. After customers
out the price and value of early scheduled maintenance, Lexus is rolling out a system to cut appointments from two hours-plus to just 25 minutes.

utives at this package delivery company's headquarters first put in several years as a driver to learn the business from the ground up. New route-
ion and GPS technologies are boosting reliability further, even alerting drivers when they pull into the wrong driveway.

ly-run rental car firm is serious when it comes to tying rewards to customer satisfaction, which it measures through its "Enterprise Service Quality
(SQi). Branch managers say they're in "ESQi Jail" when their scores are below average, since they can't get promoted until their scores rise.

al baristas at Starbucks get a full 24 hours training, which better prepares them to stay calm and courteous in high-traffic situations. To keep improving
managers' incentives are tied to the ratings they receive from disguised Starbucks "quality assurance" agents, who visit at least three times a quarter.

ence the chain's personalized service firsthand, new hires fill out a survey of preferences on the first day of orientation, and then are treated to their
inks, candy, and CDs during breaks. Last year, Ritz spent \$6 million to integrate software systems, giving staffers a better view of customer favorites.

year-old insurance company grew for years by word of mouth—the firm did not advertise until 1998. That's long left customers feeling like part of a
ed, Amica does treat them like family: When serious weather such as a tornado strikes, Amica proactively calls each customer it hasn't yet heard from.

iative has Southwest exploring how to improve everything from check-in lines to baggage delivery at its 64 airports. Staffers are part of the process.
an employee idea, agents now place red, yellow, or green magnetic cards on the gate door to let other employees know when they need help.

the bank is known, pioneered a now patented branch format that includes features borrowed from retail, such as "concierge" greeters in the front of
h. It measures how individual branches do on customer service by producing a loyalty score for each "store" that's tied to compensation.

dates for Cabela's contact center and retail stores must pass a difficult 150-question test that measures the depth of their outdoor sport expertise.
ith, senior executives gather for a one-hour "call review" to listen to customer calls while watching the same screens available to service reps.

ment of this broker-dealer works hard to insure all associates make superior service a priority. Top brass regularly attend the firm's "Service 1st" events,
lude monthly luncheons and events with motivational speakers who have a service-oriented message.

pc sports car company is famous for its customization services: True Porschefiles need not have a car that is like anyone else's. When a car does need
Porsche dealers don't make their customers stoop to lower brands, but lend customers another Porsche.

set itself apart from other electronics makers through its stores, where customers make appointments online and then cozy up to the Genius Bar for
support. All "geniuses" travel to Apple HQ for training. Still, critics lament its hard-to-service product features and inconsistent responses from reps.

t this grocery chain receive bonuses based on their unit's performance and share grants as part of their incentive plan. It's hard not to put on a happy
customers when those grants are up 29% annually for the past three years. Publix estimates it spends nearly \$3,000 training each employee.

less-enabled "Portable Rent" laptops help employees rent cars to customers waiting in long counter lines. Hertz is the only brand on our list that gets
n Gethuman, a consumer-advocacy Web site that grades companies on their phone-support quality.

ing giant was first to offer overnight delivery, guarantee 10:30 a.m. deliveries, and let customers track the status of their packages. A \$15 million
nt in training at the Kinko's chain, which it acquired in 2004, cut complaints by 65% and raised on-time orders by 20%.

managers know what it's like to be on the front line: Nearly 3,000 of them began their careers in hourly jobs. After JW Marriott, Marriott's top-end brand,
paper comment cards with online surveys, responses shot up 50%. Customer comments are accessible to managers on a hotel Web site each Friday.

s are not eligible for a bonus unless they pass "Retail Certification"—working a week in the retail store plus an extra day during the holidays. Senior
dent of Sales and Customer Service Sue Nokes has instant street cred in T-Mobile call centers: She started as a customer service agent herself.

been a mainstay at the top of customer satisfaction lists in part because of the brand's good quality: Fewer trips to the dealer equals happier
s. When repairs are needed, dealers try to make sure customers have a ride or a loaner car to get to and from the dealership.

oyal customers give the brand's salespeople high marks for the consistency of their service. The long tenure of many dealers helps build strong
ips with many of the brand's largely older customers.

1 USAA

Soldiering On In Insurance

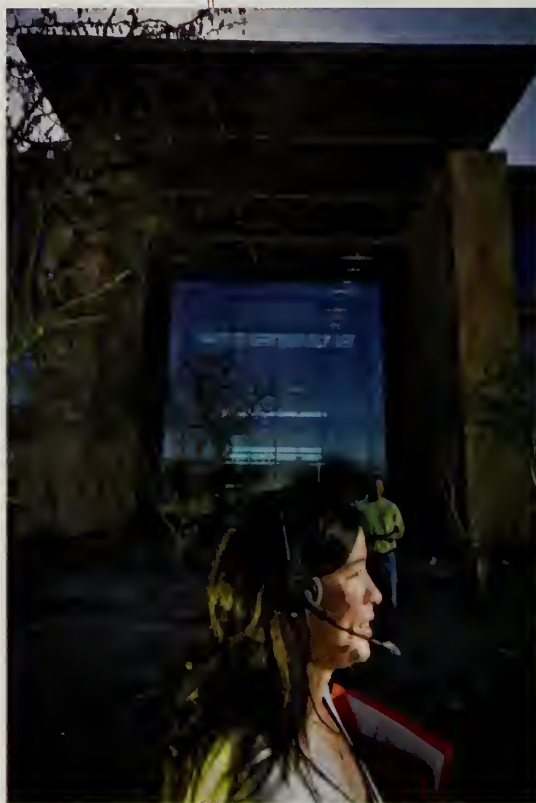
IT WAS STEVIE Salinas' second day of new-hire orientation when retired Lt. Col. David Sheets appeared in the doorway. "Atten-hut!" he commanded, bringing the room of 50 new employees to their feet. Surprised, the 23-year-old single mom watched as Sheets handed out manila envelopes. Inside was a deployment letter identical to that received by the military. "Report to the personnel processing facility," the letter began, demanding recipients depart the next day.

Of course, Salinas, a fledgling member services representative, didn't actually have to ship off. Lt. Col. Sheets' appearance was part of an enhanced military awareness program begun last year by USAA, the San Antonio financial-services company whose auto and home insurance products are limited to military members and their families. Earlier the same day, the five-foot-tall Salinas had strapped on a military helmet, 65-lb. backpack, and flak vest. She'd eaten a "meal ready to eat," or MRE, the grub soldiers eat in the field. She even read real letters from troops in Iraq. Hers was from a soldier who later died in the war and was addressed to his mother. "We were in tears," says Salinas.

Many companies give lip service to listening to the "voice of the customer." At USAA, that voice is transformed into what it calls "surround sound"—a comprehensive approach to training its employees to empathize with its customers' unique needs. "We want to cover the light moments, the heart-wrenching moments, what it's like to be bored in the field," says Elizabeth D. Conklyn, USAA's executive vice-president for people services. "We try to develop empathy, not only for our members but also for the family side."

Such awareness efforts are helped by the fact that some 15% of USAA employees come from the military. Policy service manager Chin Cox, an Air Force reservist, calls her team of call center reps "troops" and uses military time. When her 17 agents had to work on a recent Saturday, she gave out MREs as a reminder that, while the cafeteria was open, soldiers in the field don't have options. "For one split second they're in the boots, so to speak, of our troops," says Cox. "The reason we have choices is because they're out there giving up theirs."

—Jena McGregor



department, circling the issues he'd like to have addressed. While treating employees right and staying close to the front lines may sound like simplistic platitudes, they're also the hard truth about the hard work of getting service right.

Most of the companies on our list also know how to respond when service goes wrong, as Southwest did in Emig's case. Even customers of the best companies suffer the occasional long wait, crabby rep, or mishandled billing statement. Much rarer is the sort of spectacular service catastrophe that befell JetBlue recently, when an ice storm stranded passengers on planes for as long as 10½ hours at New York's John F. Ken-

nedy International Airport. A disastrous cocktail of aircraft congestion, frozen equipment and poor decision-making led to a massive airport snarl and days of cancelled flights that could have a lasting impact on the airline's customer-friendly reputation. The airline originally came in at No. 4 on our list—J.D. Power surveyed customers in early 2006—and has a history of great service. But in the wake of such a massive operational meltdown, we decided to take a wait-and-see approach this year before naming it one of our Customer Service Champs. The airline is working hard to repair its image with customers and promising a vast overhaul of procedure. But the true test will be how it executes on those commitments in the months and years ahead. "They're going to be suffering from this for a long time," says Valarie Zeithaml, a professor of marketing at the University of North Carolina's Kenan-Flagler Business School, who has written about service recovery. "But I trust that this CEO at this organization is going to come up with some new way to recover."

ARMY STYLE Policy service manager Cox calls her call center reps "troops" and uses military time

That hardly means the other names on our list are perfect. Seeing a cell-phone carrier on our top 25 is sure to raise eyebrows—the wireless industry is notorious for poor customer service. In our view, however, comparing phone companies to luxury hotel chains is a little like pitting a Division III school against perennial powerhouse Duke University in the last round of the Final Four. So we instituted a bonus system that gives brands credit for doing well within their industry, catapulting names like No. 23 T-Mobile and No. 18 Apple Inc. into the mix. While Apple's customer service shows bruises—device problems frequently erupt just after warranties expire—the in-person support offered at the "Geni Bars" in the electronics maker's more than 170 stores sets it apart from its peers.

That more equitable approach pushed some well-known service brands just below our top 25. Low-cost brokerage firm Vanguard, whose top executives are each trained to man-



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AND I WORK AT A
CUSTOMER CALL CENTER.
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TO LEAVE HOME.**

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INTELLIGENT COMMUNICATIONS



phones during heavy call periods, showed up at No. 26. Just below came Saturn, which built its brand on no-hassle sales and service for the average American car buyer. Another strong contender? Reader nominee Ace Hardware, which beat out Home Depot Inc. by a mile. Ace came in at No. 32, while the big-box retailer, whose service has come under fire in recent years, landed decidedly in the bottom half.

Perhaps the most repeated theme we heard from the brands on our list was the need to improve continuously, no matter how many accolades they receive. Nordstrom (No. 4) initially declined to speak with us entirely, saying "we don't consider ourselves experts." Four Seasons Hotels & Resorts (No. 2) has been trying to enhance the check-in process for customers, a service that's in little need of improvement. "We call it having a healthy paranoia," says Craig Reid, senior vice-president of operations for the Americas. So over the last 18 months the hotel has been quietly extending curbside check-in. It aims in advance to identify customers who've stayed at the hotel as infrequently as five times and literally hand them their room keys as they step out of the car.

THE RITZ-CARLTON HOTEL CO., NO. 11 ON our list, is raising the bar, too, layering on a richer, more customized experience to its traditional service standards. The luxury hotel chain has long been heralded for the consistency of its service. So much so that managers from other companies flock to its Leadership Center, where Ritz managers share their secrets. Both Starbucks Corp. and Lexus have sent executive pilgrims.

But that consistency also has a downside. Until recently, both Ritz' service and its hotels could be, well, too consistent. Its exacting 20 service standards could be too formal—the "certainly, my pleasure" treatment didn't always sit well with the thirtysomething venture capitalist in jeans tapping away on his BlackBerry. Slavish devotion to consistency also led to some design dissonance: The chain's modern South Beach property in Miami had a harp—a stock piece of decor—sitting in the sleek Art Deco hotel. "We were a little too cookie-cutter and robotic," says John Timmerman, vice-president of quality and productivity.

In addition to adding flexibility to its service standards, Ritz executives decided they needed a "scenographer"—someone who, as with a play, could help them direct "scenes" for the customer, but through customized service, rather than light-



An Extraordinary Stumble at JetBlue

YOU'VE GOT TO GIVE the guy some credit. It's not every day the CEO of a public company—especially a CEO who's just emerged from a crisis like the one JetBlue Airways CEO David Neeleman weathered recently—shows up on the *Late Show With David Letterman*. But there he was on national TV just after midnight on Feb. 21, suiting through guffaws at his expense ("We'll make him wait for a change," Letterman told Barbara Walters, who preceded Neeleman as a guest) and somberly promising that his airline would do better. "What will you do now," Letterman asked as the crowd roared, "to keep JetBlue from being the punchline to a joke—which is my contribution?"

Good question. Since Feb. 14, when a devastating ice storm shut down JetBlue's home base, New York's John F. Kennedy International Airport, the airline has been digging itself out of an operational and public relations quagmire. Suddenly the carrier that was going to "bring humanity back to air travel" was trapping passengers on planes for hours, canceling more than 1,000 flights over six days, and admitting to near-chaos in its operations. "We should have acted quicker," says Neeleman. "We should have had contingency plans that were baked to be able to [unload] customers. We should have called the FAA Authority quicker. These were all lessons learned from that experience." (Read Maria Bartiromo's interview with Neeleman on page 90.)

Sharpen your pencils, business school pros. JetBlue's service recovery has all the makings of a Tylenol-caliber case study, starring a repentant CEO, a host of grand gestures to customers, and a few publicity coups (like *Letterman*). Still, the road to recovery isn't paved with TV appearances. What matters most is execution—doing the hard, organizational work to ensure the crisis never happens again. While JetBlue recognizes that fact, it still has plenty to prove, especially to those passengers fuming over their ruined vacation or time lost to the inside of an airplane.

That's why we decided, despite its initial No. 4 spot on our ranking, which was based on consumer responses from the first half of 2001, to yank JetBlue from our list of Customer Service Champs. It was a

brilliant

cretins

JetBlue has piled up service accolades faster than most airlines complaints, winning the University of Nebraska's national Airline Rating study each year since 2003, a Readers' Choice Award from *Condé Nast Traveler* for five years running, and ranking in the very measured category in the airline satisfaction ratings by J.D. Power & Associates.

But at, plus JetBlue's own trumpeting of its customer-friendly reputation, means its passengers' expectations are inevitably higher than other airlines, after all, had long waits at JFK, too: JetBlue's average delay between Feb. 13 and 15 was 230 minutes, according

more than Northwest Airlines handed over following its infamous plane delays in 1999, and quicker than American's response to its December flights full of customers stranded on the runway for as long as eight hours. But the centerpiece of Neeleman's strategy is a new Customer Bill of Rights, a written policy unique among U.S. carriers that JetBlue announced on Feb. 20. It requires the airline to dole out vouchers or refunds in certain situations, such as \$100 for passengers on arriving flights unable to reach their gates in one to two hours or \$50 for any two- to four-hour delays caused by events under JetBlue's control.

Creating a "service guarantee" is a smart move, says Leonard L.

Berry, a Texas A&M University marketing professor and author of books on customer service. His research shows that the two biggest ways a company can destroy a service reputation are when its service proves unreliable—as JetBlue's did recently—and when the company doesn't seem to be fairly resolving its problems. Berry warns, however, "that a well-executed service guarantee is very clear on what is guaranteed and what is not." Currently, JetBlue's policy doesn't outline what is under its control and this could cause confusion. It says it will be adding more details.

Neeleman is doing far more than just apologizing and outlining refunds and guarantees. He's making a host of changes he believes will help JetBlue keep future weather-related operational snafus from spiraling out of control. He's overhauling information systems that track crew whereabouts, upgrading JetBlue's Web site to allow online rebookings, and training workers at New York headquarters to help out at the airport. When future disruptions occur, a SWAT team of corporate types will head to the airport—JFK is just seven

miles from JetBlue HQ—to load bags, man computer stations, and help get incoming planes ready to leave again. "Had we been able to go out and help those [employees] who were exhausted to turn planes around quicker, we could have been back to normal by Friday or Saturday" says Neeleman, rather than the following Tuesday. On *Letterman*, he vowed that "we are going to rebound from this." If he can make good on that, JetBlue will indeed be a Customer Service Champ—and Neeleman need never again ask for forgiveness on late-night TV.

—Jena McGregor



KEY ONES At least these stranded JetBlue passengers at JFK didn't have to wait the hours-long wait while stuck inside a plane

Stats, a travel data company, while Delta Air Lines' was 18 minutes and American Airlines' 202. But interminable delays, cancellations, and service snafus, says UNC Kenan-Flagler Business School marketing professor Valarie Zeithaml, can be "more detrimental [to JetBlue] than to a larger airline. It runs totally counter to who they are and saying they are and what they live." It means JetBlue has to respond differently. Its first step toward fixing the problem was to offer immediate refunds and travel vouchers to passengers stuck on Valentine's Day planes for more than three hours—far

RICHARD DREW/AP PHOTO

SHARE YOUR THOUGHTS.

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ing or props. The luxury chain tapped Palo Alto (Calif.) design firm IDEO. "We wanted to bring a little something extra out of each hotel that helps to make the experience personal, unique, and memorable," says Len Wolin, senior director of program management for Ritz-Carlton. "But most of all, we wanted it to be subtle."

IDEO went to work creating a set of "scenography" workbooks. These helped a group of each hotel's most creative staffers brainstorm localized service scenes, such as a warm, personalized check-in process or a "big night in," in which the executive chef might send up a handwritten note, a champagne toast, and a sample from the night's menu for guests with restaurant reservations. At San Francisco's Half Moon Bay hotel, guests are now invited to an intimate wine tasting at

check-in. As a reminder to keep the ideas understated, IDEO worksheets urged staffers to come up with ways the change could get out of hand. The localized touches "should be almost subliminal," says IDEO's Dana Cho, who led the project. "You never actually say it out loud to the customer."

While such personalized treatment may sound dreamy, for most of us customer service is an aggravating maze of automated phone trees and scripted voices resonating from halfway around the world. But while offshoring call-center work is still growing steadily, companies are getting smarter about what they send overseas. "I think we're seeing some backlash," says Bruce Temkin, Forrester Research Inc.'s principal analyst for customer experience. "Companies are pulling some [more complex types of calls] back from offshore, and in other cases are recognizing they need to invest more in those facilities to give reps more tools and training."

One encouraging alternative trend, at least for those of us on the other end of the phone line, is "homeshoring" in which service agents armed with broadband line, a computer, and a quiet

LOCAL HERO A new system dispatches drivers more quickly for pickups

for the majority of its 56,000 drivers. So sophisticated is the software that it designs each route to minimize the number of left turns, thus reducing the time and gas that drivers waste idling at stoplights.

UPS's innovation is an example of how technology can help companies capture institutional knowledge about their customers. Before, when a truck loader or driver walked out the door, the package-loading techniques or route tips they'd developed over the years usually walked out with them. Now that knowledge is accessible in a central system. That eases the burden on substitute drivers and shortens the training time for new ones, lessening the chances of a lapse in customer service. There's no question the new system has enabled UPS to run its routes more efficiently. In November

alone the company's drivers logged 3 million fewer miles than they did the year before.

The latest wrinkle: a new feature, that, with the aid of global positioning system technology, warns drivers with a beep if they pull into the wrong driveway. It also enables UPS to send a driver more quickly after you call in a pickup since dispatchers know exactly which driver is closest. And later this year, UPS plans to use its package-flow technology to launch a service that allows customers to reroute a package in transit to a different address. "We're trying to become a paradox: to be the biggest [delivery] company but also the most flexible," says Kurt Kuehn, senior vice-president of worldwide sales and marketing for UPS. "We have not reached the endgame."

—Dean Foust in Atlanta



8 UPS

How Technology Delivers for UPS

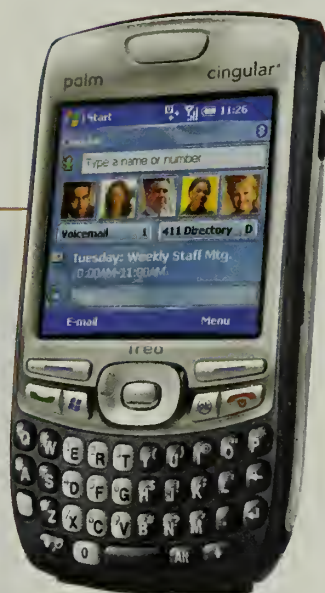
IT'S A FROSTY TUESDAY morning in February, and Marc Freeman, a veteran driver in Atlanta for United Parcel Service Inc., checks his handheld device and discovers he's in for a busy day: more than 400 packages to deliver, a task that until recently would have left him still banging on customers' doors well after dark. But thanks to a custom-built software program UPS began rolling out two years ago, Freeman will easily finish his deliveries by 6 p.m., ensuring that his customers get their packages on time and that he makes it home for dinner.

Not so long ago, UPS drivers worked off maps, 3-x-5 note cards, and their own memory to figure out the best way to run their routes. That changed in 2005 when UPS began to implement a \$600 million route optimization system—think MapQuest on steroids—that each evening maps out the next day's schedule

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3 CADILLAC

Looser Rules, Happier Clients

IT'S ONE OF THOSE teeth-gnashing, rage-inducing experiences: Mere miles or months after your car's warranty expires, you find that it needs expensive engine repair. Car companies have for years kept goodwill funds for dealers to draw on in such situations. But until about a year ago, Cadillac, No. 3 on our list, had rigid rules that made dealers jump through hoops to get at those funds. Dealers had to call a regional representative at parent company General Motors Corp. for permission to do work free of charge outside of warranty. If the repair was expensive, they had to go even higher up the chain of command, sometimes as far up as Cadillac general manager James E. Taylor himself.

That put dealers at a disadvantage with archrival Lexus. Since Lexus has 221 dealerships to Cadillac's 1,400, each Lexus outlet is more profitable and can better afford to offer such perks as loaner cars and repairs for vehicles that recently went off warranty. So last year Taylor decided to loosen up the rules, giving dealers the power to decide how to respond to customers with repair needs outside of warranty. If dealers become too generous, Cadillac will tell them.

By making that change, Taylor resolved a classic frustration for many customers: Too little decision-making in the hands of employees on the front line. Says Taylor: "Luxury customers are used to staying in five-star hotels and having secretarial staff take care of everything. They expect dealers to take care of them, and we have to give dealers leeway to do that." The brand guarantees its customers a loaner car to drive while repairs are being made and reimburses dealers up to \$45 a day for the cost.

Cadillac is also keeping a closer eye on its mechanics. It can track data to find out if certain dealerships or even individual technicians are frequently making the same mistakes in repairs. Taylor says that making the extra effort is worth it. GM research shows that customers who get good service are five times more likely to buy another car from the same brand than those who have had a bad experience. "You have to believe that the added cost comes back to you in spades in customer loyalty," he says. To keep that virtuous cycle going, GM gives its dealers perks for doing the job right. If dealers maintain good customer-service ratings, based on surveys, those with larger operations can get cash rewards of up to \$100,000 a quarter.

—David Welch in Detroit

corner in their spare bedroom respond to calls at their home. Service can be better for customers because homeshoring attracts more experienced workers with more education than regular call centers. Stay-at-home moms are a big part of the labor pool and like the flexibility and nonexistent commuting costs of the home-based model. That makes them more loyal, keeping turnover lower and experience levels higher. Companies that outsource calls to home-based agents report turnover rates in the 10% to 30% range, compared with anywhere from 60% to 100% in the average call center.

It should be encouraging for companies, too: Between overhead, pay, and training, home-based agents cost companies about \$21 per rep per hour, vs. \$31 in a stateside call center, says Stephen Loynd, program manager for contact center services at market research firm IDC. Loynd expects homeshoring to be a booming trend this year, reaching 328,000 home-based agents by 2010, up from just 138,000 last year.

One other upside to homeshoring is that heavy call volume can be quickly addressed by sending out an all-points bulletin urging home-based agents to sign on. Still, there has to be good communication with agents and incentives for them to log the extra hours. For instance, during JetBlue's recent opera



VEGAS DEALERSHIP Cadillac dealers now have more leeway in offering free repairs outside of warranty

ational snarl, customers quickly overwhelmed the reservation system at the company, which employs reservation agents to work from home. While the airline says it has the capability to "flex up" its number of agents, it also had trouble reaching them during the crisis and staffing up. As a result, the airline is instituting a "Code Red" signal that will require agents to work an extra three to four hours a day during occasional emergencies and pay them double for that time.

The home-based outsourcing model, with its more experienced agents working at home in jeans and slippers, fits with the idea that happier frontline folks will make for happier customers. That's not just true for call centers. While 19 Publix Super Markets Inc., a popular grocery chain in the Southeast, is privately owned, it bestows shares in the company to employees as part of a profit-sharing plan and gives them the opportunity to buy more. That may seem like a home-based benefit, but the company's shares have appreciated 29% an

PLAYBOOK: BEST-PRACTICE IDEAS

At Your Service

Creating consistently good customer experiences is one of the hardest tasks in business. Here are ideas from our winners:

Establish Customer Empathy

Rank-and-file workers often have little in common with customers: Many of USAA's support reps aren't in the military, and Four Seasons housekeepers can't exactly afford the luxury chain's pricey hotels. Both companies provide staffers with chances to understand the customer's experience, such as tasting soldiers' "meals ready to eat" or staying in the hotel for free.

Connect Pay To Service

To keep customers' needs in frontline managers' minds, failures have to hit them where it hurts—in their wallets. Many of the names on our list, including Starbucks and Washington Mutual, make customer satisfaction a factor in setting pay. At Enterprise Rent-A-Car, branch managers can't receive promotions unless their scores are at least the company average.

Adapt Tools To Your Needs

Be careful of off-the-shelf employee assessment products, especially when it comes to hiring people on the front line. After Four Seasons tried out a standardized tool, it realized the test would have overlooked its most service-minded employees. Instead, it studied its best staffers to identify the attributes it would look for in new candidates.

Consider a Chief Customer Officer

While there's danger in creating such a role—other managers could see customer service as something that isn't part of their job—it can have an upside if structured right. Putting customers first requires collaboration in everything from marketing to operations to human resources and may require someone whose day-to-day job is to coordinate the effort.

Involve the Very Top

No matter how effective a chief customer officer may be, participation from the top is key. At Cabela's, Vice-Chairman James W. Cabela spends a few hours each day reading customer comments, hand-delivering the ones he wants resolved. Says Vice-President of Customer Relations Ron Spath: "When Jim Cabela puts them on your desk, you pay attention."

for the last three years. Publix management works hard to convince workers that if they treat the customer well, they'll be rewarded through the stock. "Don't look for a reason why you won't take care of a customer—look for ways you can," says Bob Moore, vice-president for Publix. The grocery chain also says it pays employees more than competitors, including average salaries for managers that are 20% to 25% higher. The connection between satisfied employees and contented customers is hardly a new concept: Any business-school student can recite by heart the concept of the "service-profit chain," which draws the inextricable link between the front line and satisfied customers. But new research from Katzen-

bach Partners offers an updated metaphor. The firm stresses the importance of an "empathy engine," which looks at the role of the entire organization, including middle and senior management, in providing great service. If that engine is thought of as a heart, "the whole company has to pump the customer through it," says Traci Entel, a principal at Katzenbach Partners who recently studied 13 leading service companies' best practices. "It starts much further back, with how they organize themselves, and how they place value on thinking about the customer."

Helping employees become more empathetic with customers was a common focus among the brands on our list. For



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Transforming
IT Management

instance, USAA, whose home and auto insurance are only open to military members and their families, serves new employees MREs (meals ready to eat) during orientation so they can better identify with military life (page 56). All frontline workers at Cabela's, the outfitter famous for its massive retail shrines to hunting, fishing, and camping, partake in a free product-loaner program. Staffers are encouraged to borrow any of the company's more than 200,000 products for up to two months, so long as they write a review that's shared via a companywide software system when the goods are returned. That's not only a perk for employees; it also helps them better empathize with product issues customers might have.

But few places make empathizing with customers quite as luxurious an experience as Four Seasons Hotels. At most of its properties, the final piece of the seven-step employee orientation is something the chain's executives call a "familiarization stay" or "fam trip." Each worker in these hotels, from housekeepers to front-desk clerks, is given a free night's stay for themselves and a guest, along with free dining.

While there, employees are asked to grade the hotels on such measures as the number of times the phone rings when calling room service to how long it takes to get items to a room. "We bill it as a training session," says Ellen Dubois du Bellay, vice-president of learning and development. "They're learning what it looks like to receive service from the other side."

That's key when your product is out of range for many

employees—a \$400 room rate isn't exactly easy to swing on a housekeeper's budget. But the perk doesn't stop at orientation: After six months of service, employees may stay up to three nights a year for free. By 10 years, they get 20 free stays. As you'd imagine, "there's a very healthy uptake," says du Bellay. Four Seasons' creative but practical approach reveals one of the most powerful secrets of world-class service: helping employees to understand what it feels like to be a customer. Thinking like that distinguishes our Customer Service Champs from the rest of the field. ■■

—With Frederick F. Jespersen and Megan Tucker in New York and Dean Foust in Atlanta

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ABOVE AND BEYOND

TELEVISION: Watch as *BusinessWeek* Weekend chats with a Ritz-Carlton concierge about providing personalized service.

ONLINE: View slide shows of the worst recent customer service gaffes and our top 25 list.

ONLINE: See Atlanta Bureau Chief Dean Foust don UPS brown and video his morning with a driver serving customers.

ONLINE: Explore an expanded, interactive version of our Customer Service Elite table.

PODCAST: Listen as Executive Editor John A. Byrne gets the story behind the story from Jena McGregor at businessweek.com/podcast.

THE METHODOLOGY

What it Takes to Be a Winner

TO DETERMINE THE WINNERS of the *BusinessWeek* Customer Service Champs, we first turned to J.D. Power & Associates, which measures customer satisfaction. Its research includes data on a range of industries such as airlines, hotels, and automakers. Because we were interested in measuring customer service, we used only results related to what customers think about a company's "processes" (its return policies or reservation procedures, for instance) and its "people" (their friendliness, say, or expertise levels). Therefore, our results may differ from J.D. Power's customer satisfaction rankings, which consider product quality, presentation, and price. We reserved the right to cut from our initial ranking companies about whom unfavorable information has come to light.

We began by aggregating the scores for each individual brand across the complete studies in J.D. Power's 2006 database. (A bank, for instance, might have separate studies that analyze a customer's branch, car loan, and mortgage experiences.) Only brands with at least 100 responses and with both "process" and "people" scores were considered.

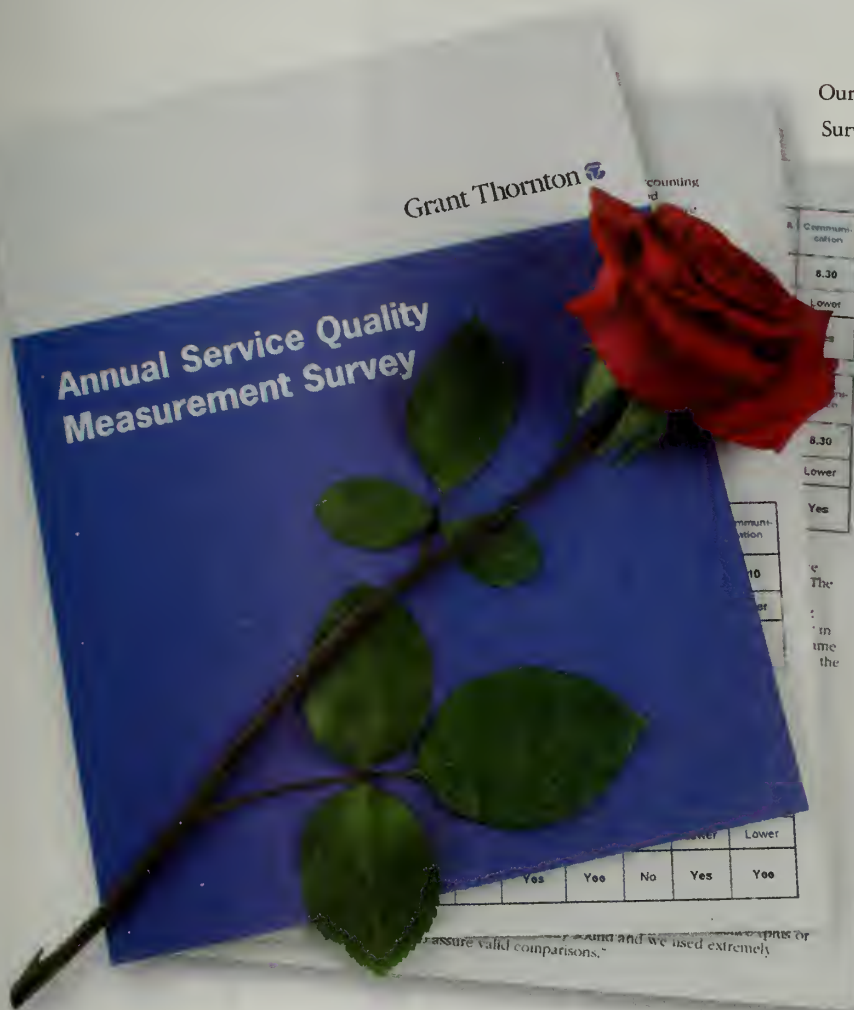
We then eliminated industries that cater to niche markets, such as motorcycles, and about which consumers rarely make decisions based on service, such as homebuilders. To create a more nationally oriented list, we removed brands that did not have at least \$1.5 billion in annual revenues. (If a brand's parent company is in a similar business, its annual revenues were measured instead.) To compare industries across standard measures, we used a consistent set of J.D. Power's studies in each

industry and eliminated brands that did not appear on them all. Finally, in order to compare similar companies within a category, we removed dial-up-only Internet providers and hoteliers that were not in the upscale or luxury categories or did not have a significant U.S. presence.

To supplement the brands in J.D. Power's database, we also surveyed 3,000 *BusinessWeek* readers and asked them to nominate three companies they felt were best and three they felt were worst at providing customer service. More than 1,000 readers responded with 2,423 "votes" and 1,850 "complaints." For brands that received a high number of votes and a low number of complaints and were not part of J.D. Power's research, we created a Web-based questionnaire and surveyed at least 100 customers.

Finally, we aggregated both sets of data, combining the people and process scores to establish the "Service Score." The people score was weighted at 63% and the process score at 37%. (We used percentages that represented their average importance to determine J.D. Power's satisfaction scores.) Then, because we were comparing very different industries—booking a romantic weekend at the Four Seasons is a far cry from trying to dissect a monthly wireless bill—we gave credit for ranking high within an industry. Brands that ranked first in their category received 100 bonus points; those ranking second were awarded 50. We subtracted 50 points from each brand that fell below third place and 100 points from those that came in last in categories with at least five brands. We then translated the numerical scores for people and process into 10 letter grades.

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A Career Gets Juiced

Alton Johnson was going to be a banker. Then he stumbled upon açai



BY AMY BARRETT

DURING A TRIP TO BRAZIL in 1999, Alton Johnson kept hearing about açai. The tart rainforest berry was said to provide an amazing energy boost. Some even claimed it had Viagra-like effects. A few years later, while Johnson was working on an MBA from the University of Southern California, he decided to find out if there was any truth behind the lore. He paid Brunswick Laboratories, a research lab in Norton, Mass., \$1,000 to do a study of the berry. Its finding: that the açai contains more antioxidants, thought to offset cell damage that can lead to cancer, than even the much lauded pomegranate and blueberry. Johnson was sure he was on to something. "I knew this berry had enormous commercial potential," says the 37-year-old.

In 2005, Johnson's startup, Los Angeles-based Bossa Nova Beverage Group, launched its line of açai juices. Having a little science cred—the findings are proclaimed in a bar chart on the label of every bottle—has helped Bossa Nova win fans, particularly baby boomers looking to fight

the ravages of time. It also has helped get the juice, which comes in flavors including passion fruit and raspberry, onto the shelves of retailers, including Whole Foods, Wegmans, and Wild Oats. "They did their research and came up with flavor profiles that were appealing," says Charles Gardner, who oversees Wegmans' natural and organic department. Jonathan McParland, a buyer for Wild Oats, which has carried the juices since July, 2005, says some customers found other açai products, such as smoothies, too heavy. "It's a

BUSINESSWEEK
SmallBiz

huge seller," McParland says of Bossa Nova's açai juice. "And it's been growing year after year." The 10-person company, which manufactures the juice in California, had \$4 million in sales last year. Johnson says he will announce a distribution pact in April that will help put the product in 10,000 locations, including airports and universities, in 2007, up from 3,500.

Johnson sounds a bit surprised about where he has landed. "I never planned to be an entrepreneur," he says. After college the Illinois-born son of two auto workers became a marketing executive for consumer-electronics company Harman International Industries Inc. He started his MBA expecting to become

an investment banker. A class project to write a business plan changed things. Johnson based his on an açai juice product, and won a 2002 business plan competition at the school. Among the judges was Lloyd Greif, who endowed the Lloyd Greif Center for Entrepreneurial Studies at USC and whose investment banking firm Greif & Co. now holds a small equity stake in Bossa Nova. "This is a company with a great product, great marketing and great technology," says Greif.

CREDIT-CARD STARTUP

AFTER FUNDING the Brunswick research and then graduating, Johnson worked with Stephen T. Talcott, an assistant professor at Texas A&M University who had done some work on the berry, to develop a process to turn the fruit—which spoils within 24 hours of harvesting if not frozen—into a juice. Bossa Nova has filed nine patents on the processing technology and juice formula.

Early in 2005, after burning through \$400,000 in startup cash raised in part

JOHNSON He got from friends and family, Johnson raised up his credit card to cover the cost of a \$25,000 booth at a marketing materi-

al trade show in Anaheim, Calif. "I was scrounging for every penny," Johnson says. He left that convention with commitments from a dozen supermarket chains. That summer, Greenmont Capital Partners, a venture-capital firm, invested \$500,000. This past January, Johnson raised \$7.5 million more, primarily from an undisclosed institutional investor.

Still, Bossa Nova has its work cut out for it. Amy Howell, an associate research scientist at Rutgers University, says although açai berries are high in antioxidants, the health benefits are unclear. Studies in humans have shown that pomegranate juice, for example, may slow the progression of prostate cancer. But the açai berry has been studied extensively. "The açai has a lot of promise," Howell says. "But we have to wait until [clinical] studies show some benefit."

To that end, Johnson continues to work with Talcott on studies of the berry. And Bossa Nova recently recruited a chief operating officer from Kraft Foods Inc. All of which shows that Johnson is no longer scrounging. In February, Johnson wrote a six-figure check to his parents, reimbursing them for money they lent him when Bossa Nova was struggling. Says a proud Johnson: "I paid them back—with interest." ■



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Just Don't Call Him a Raider

Carl Icahn, who now styles himself a shareholder activist, prepares for battle

BY RONALD GROVER

CARL ICAHN HAS BEEN chasing bogeymen for much of his life. In the early years the man who would come to symbolize the 1980s corporate raider went after slow-moving companies. Overpaid executives, timid boards, even a biotech company or two fell victim to the pioneer who helped usher "greenmail" into the takeover playbook. Over three decades, he forced giants such as Phillips Petroleum Co. and American Can to the table. These days the 71-year-old has found a new bogeyman: private equity investors.

In a twist of logic that might baffle those who know his history, Icahn, the raider turned self-styled "shareholder activist," says it's the private equity investors who are today's raiders. They go after companies with mounds of cash and undervalued assets, then rip them apart and enjoy the spoils. How different is that from Icahn? Not much. But for Icahn, who will likely wage four or more proxy battles this spring, it's enough. "Cash is a great asset," he says. "But if private equity investors get their hands on it, they'll reap the benefit instead of the shareholder." And Icahn? When he goes after a company, most often it stays public, and he says shareholders who take the ride with him gain from his activism.

Carl Icahn, white knight for the common man? Hard to put a frame on that picture. But as Icahn prepares for a possible proxy battle to force himself onto the board of Motorola Inc., he says he's fighting to give shareholders a hefty bonus by forcing the cell-phone maker to buy back a chunk of its stock. That's unless his presence lures private equity buyers into a bidding war that would generate serious upside for shareholders—including Icahn and his investors, who already own 1.39% of the

company and are probably buying more.

Four filings in one proxy season would likely put Icahn in the raider hall of fame. Armed with a war chest approaching \$6 billion, he has filed proxies to elect board members at forest-products company Temple-Inland and homebuilder WCI Communities. He may be contemplating a proxy battle against biotech company MedImmune, where he recently bought an \$89 million stake, and might push the company to put itself on the block. At the same time, Icahn's 86.5%-owned holding company, American Real Estate Partners, is finalizing a \$5.3 billion takeover of autoparts maker Lear Corp. "I don't know if this is a record, but he's certainly at the front of the shareholder activist buffet line," says Patrick McGurn, executive vice-president of proxy consultant firm Institutional Shareholder Services.

DANGEROUS

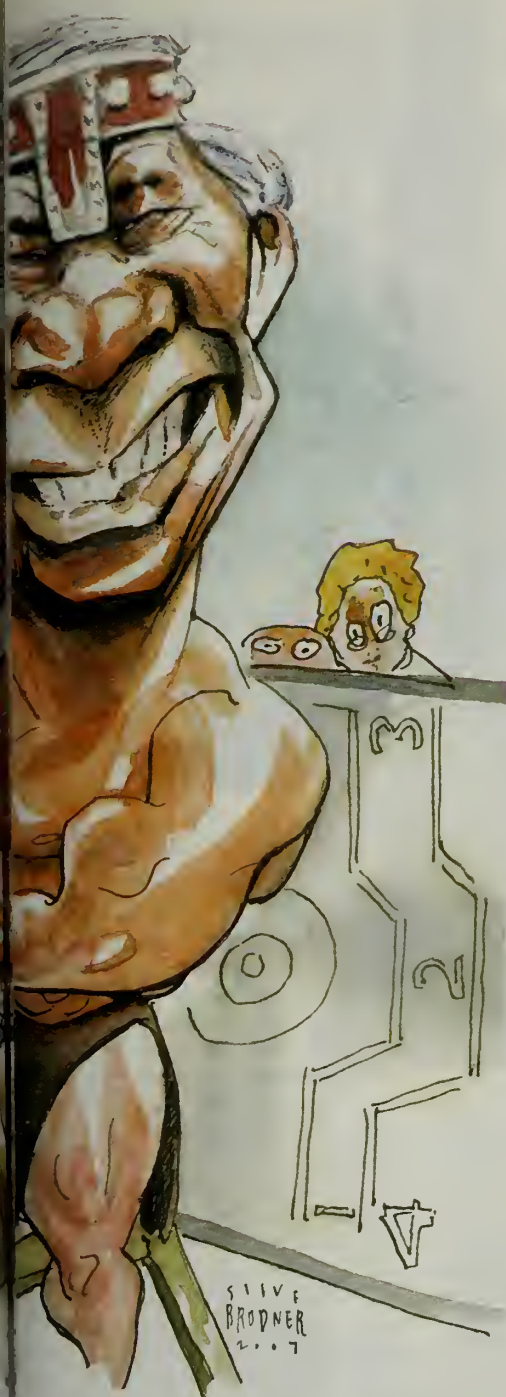
MOTOROLA'S BOARD has been mulling ways to respond to Icahn. The odds of Motorola voluntarily giving him a board seat are slim. As CEO Edward J. Zander surely knows, giving Icahn even one seat can be dangerous. "He'll ask questions, challenge the CEO, and then the rest of the board starts to question," says Lawrence A. Rand, a co-founder of public-relations firm Kekst & Co., which has represented companies targeted by Icahn. That's how Icahn effectively took control of ImClone Systems Inc. last year with only 13.8% of the company's stock. He hired a board member to do his bidding, got himself added to the board, and then snipped from the inside. Eventually, ImClone's chairman quit and was replaced by Icahn.

Even if Icahn doesn't try to grab Motorola for himself, the publicity generated by his demands could put the company into play. Private equity investors are almost certainly eyeing the company, Icahn

says. Motorola isn't commenting, but so analysts agree it's attractive. Although reported dismal profit margins in its phone unit recently, it's a market leader with \$11.2 billion in cash, little debt, and a \$46 billion market cap that is historically low at one times sales. "If you cut R&D expenses and big growth efforts, it's a screaming buy," says a Wall Street analyst.

Icahn's model for Motorola is also certainly Kerr-McGee Corp., the Oklahoma-based oil and gas company caught in Icahn's crosshairs in early 2005. I





Carl Icahn

Is the last name a CEO wants to hear. Here are some tips from the battlefield.

DON'T IGNORE HIM

That's a dangerous strategy to use against a man who has a \$5.7 billion war chest and a thirst for battle. Just ask former ImClone Chairman David Kies, who resigned after Icahn felt he wasn't responsive enough to his calls to hire a better CEO.

BEWARE OF GOING HEAD-TO-HEAD

After CEO Robert Coury attacked Icahn's motives for breaking up a proposed merger, Icahn sold his Mylan Laboratories shares. Coury was happy to see Icahn go away, but Icahn was the real winner: He walked off with a \$50 million profit.

NEVER UNDERESTIMATE HIM

Blockbuster CEO John Antioco chided Icahn for his "conflicting and confusing suggestions" and said he "doesn't know our business." One week later Icahn and his allies won three board seats in a proxy battle.

PLAY NICE, GIVE HIM WHAT HE WANTS

Time Warner CEO Richard Parsons made the pilgrimage to Icahn's offices and increased a stock buyback demanded by Icahn, who then dropped his plans to launch a proxy battle.

works until 2:30 a.m., and has 22 phones at his East Hampton (N.Y.) home to help him stay in touch at all hours. At work, his staff pores over hundreds of potential targets to find its prey. "Sometimes it's like Paul Newman in *The Color of Money*," he says, recalling the pool-hustler flick. "When you hear those balls click, you know you've hit it just right." Motorola, he says, was a solid thwack.

A SOLICITOUS APPROACH

ICAHN CAN STILL launch a nasty proxy fight—just ask Blockbuster Inc. CEO John F. Antioco, who was bounced from his own board in a 2005 proxy fight despite getting the thumbs-up from shareholder rights groups. When Antioco said he would quit if he wasn't reelected, Icahn pounced, accusing him of "blackmailing" Blockbuster shareholders to collect on a \$50 million severance arrangement. Antioco didn't return calls seeking comment. With Icahn's support, the board eventually brought back Antioco, avoiding the payout.

Other CEOs have avoided Icahn's ire with a more solicitous approach. Time Warner Chairman Richard D. Parsons says he made the six-block walk to Icahn's office as a show of courtesy, and then sounded out investors who liked Icahn's plan to hike the 2006 stock buyback. Icahn, who made \$250 million on the buybacks and still owns 20 million Time Warner shares, wanted Parsons to do more. But he says the two are friendly and that Time Warner "is a great company."

When Icahn wants something, though, he can be relentless. Kerr-McGee executives recalled in a 2005 lawsuit that one Icahn aide would call or e-mail several times a day, pressing a plan to increase a stock buyback and to sell off its chemical business. Former ImClone insiders recall that Icahn himself would badger former Chairman David M. Kies with endless phone calls, once even tracking Kies down on a pre-bar mitzvah trip with his son.

Icahn and Motorola's Zander haven't yet spoken but will likely meet soon, according to sources. Those who make the effort to cozy up find him charming to a fault, even funny. During the Kerr-McGee fight, he sang songs from the musical *Oklahoma!* to break the tension, recalls Barry Rothstein, a managing director of JANA Partners and an Icahn ally. "He can actually be a funny guy," says former Viacom President Frank J. Biondi, who was recruited last year to head Icahn's slate in an abandoned proxy fight to unseat Time Warner board members. "Of course, I'm not sure CEOs on the other end are always laughing." ■

—With Roger O. Crockett in Chicago

ght in at \$71.60 a share and launched proxy fight that forced management to and \$4 billion to buy back 29% of its k at \$85 a share. Icahn made about 0 million when the company was put for sale a year later.

What drives Icahn, who vacations on a -ft. yacht and has dabbled with owning horses, to stay in the takeover business? "fun," he said recently from Las Vegas, re he was celebrating his 71st birth- with his wife, Gail. (They were tour- one of his properties, the 2,444-room

Stratosphere casino, which he bought out of bankruptcy in 1997.) Moreover, global financial conditions make it tough to quit: The world is awash in cash, interest rates are low, and executives are coming under increased scrutiny. In the past two years, Icahn has raised \$1.8 billion. He takes 25% of the profits from his funds, and his net worth is close to \$10 billion.

Icahn wages his battles from a suite on the 47th floor of a tower on New York's Fifth Avenue, aided by a staff of 20-odd lawyers and research analysts. He often

Ready to Come Back to Earth

Defense is blazing hot. But most stocks are already in the stratosphere

BY DAWN KOPECKI
AND STANLEY HOLMES

NOW THAT CARLYLE Group has bolted from the defense industry, other investors may want to ask themselves why. The buyout behemoth, which ranked as one of the Pentagon's 15 biggest defense contractors between 1998 and 2003, sold its last major holding, United Defense Industries Inc., in 2004. By 2005, Carlyle didn't even make the top 100 and has just 1% of its assets in the sector today. "The smartest guys in defense investing are out," says industry expert Pierre Chao of the Center for Strategic & International Studies think tank. "What do they see that everybody else doesn't?"

Defense companies have been on a tear since 2001, when U.S. troops invaded Afghanistan. The stocks of the biggest players—Boeing, Lockheed Martin, General Dynamics, and Northrop Grumman—have all at least doubled in that time. The SPADE Defense Index, which tracks large and midsize companies in the industry, has soared 150%, compared with a 40% gain for the Standard & Poor's 500-stock index.

But with most companies trading near their peaks, the price of war stocks is pretty high. At a recent 91, Boeing, which is also benefiting from strong sales in its commercial airplane division, sells for 42 times current earnings, compared with an average of 21 for the S&P 500. The industry, which is usually cheaper than the index, has a rich price-earnings ratio of 26. Even General Dynamics, a relative bargain at 19 times earnings, trades above its five-year average

WHAT GOES UP Big aircraft orders have Boeing shares soaring

of 15.5. It's not sustainable, says Prudential Equity Group analyst Byron Callan. "It's too late to buy, but too soon to sell."

While Northrop Grumman, General Dynamics, and Lockheed Martin declined to comment on their stocks, Jim Albaugh, CEO for Boeing's Integrated Defense Systems, seems unfazed by the recent runup. "You will see some pretty robust [defense] spending" over the next couple of years, predicts Albaugh.

For now at least, he's right: Defense spending is going up. On Feb. 5, the White House asked Congress to cough up \$481 billion for the Defense Dept.'s regular operations—an 11% increase—on top of \$235 billion for the continuing wars in Iraq and Afghanistan. Already military leaders are replacing damaged equipment and replenishing shrinking ammunition and weapon stocks, which

will help outfits like Armor Holding Inc., a key supplier of bullets and body armor.

The Pentagon also has plans for some big purchases. The Air Force just requested \$4.6 billion to buy 20 F-35 Raptor fighter jets made by Lockheed Martin, Boeing, and United Technologies. The Marine Corps placed a preliminary order with General Dynamics and Force Protection Inc. for 125 Cougar vehicles, lightweight armored tanks that protect troops from improvised explosive devices, the No. 1 cause of deaths and injuries in the Iraq war. Right now, the total for the contract is just \$67 million, but it could be worth north of \$1 billion to General Dynamics and Force Protection if the Marine Corps orders all 4,100 vehicles from the company.

"There's an immediate need for a product that fills that need, and the likelihood for profitable new sales in the near term," says Cai von Rumohr, a veteran aerospace and defense analyst for Cowen & Co.

Yet much of the good news is already priced into defense stocks, as investors have bid up the shares way ahead of the benefits to company coffers. Even more worrisome for this cyclical group, defense spending may be close to peaking, summing the security situations in Iran, North Korea don't intensify. Historic defense budgets have dropped dramatically following a major conflict. After the Cold War ended, the Pentagon cut purchases on major weapons by about 71%, from roughly \$58 billion a year in the mid-1980s to \$16.9 billion by 1995, according to the Congressional Budget Office—a dynamic that forced the consolidation of the industry in the 1990s.

Add in declining support for the war, the long-term budget challenges facing the U.S., and a Democratic Congress clamoring for cutbacks, and the Defense Dept. may be on a spending diet in the near future. "If our presence in Iraq abates, there is some potential for defense spending dropping off," Joseph Nadol, an aerospace and defense analyst for JPMorgan Securities, says. "The group overall could be vulnerable."

THE STAT

26

The industry's price-earnings ratio, vs. 21 for the S&P 500.

Data: Morningstar, Inc.

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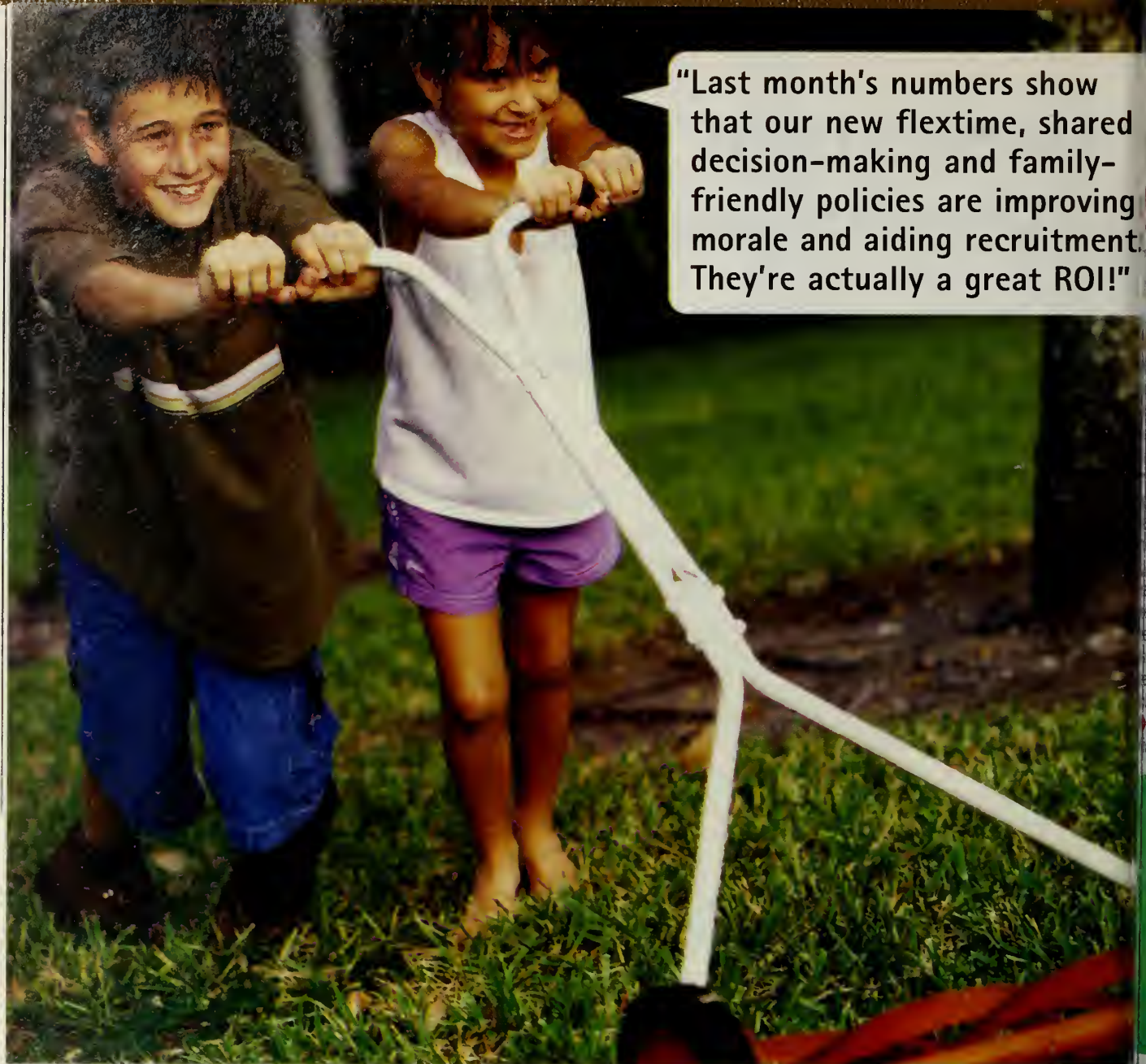
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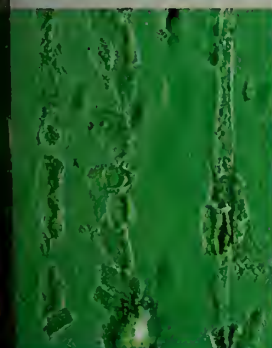
APRIL 26, 2007.

EDITED BY
LENE WEINTRAUB

INNOVATIONS

nanopumps
and tissue printers

► Scientists at Rensselaer Polytechnic Institute are using electricity to control the flow of water through carbon nanotubes. By reversing the charge in the tiny tubes, they can start and stop water streams at will. This is the first step toward designing nanotubes that can filter impurities from water and desalinate seawater. The technology might also be used for other ultraprecise tasks, such as pulling specific strands of DNA from biological samples. Researchers at Clemson University have announced



they can produce beating heart tissue using standard inkjet printers. In 2004 the team demonstrated the use of 3D printers to make cells. Others have been able to print hard biomaterials such as bone. Now Clemson scientists have refined the technology so they can place living cells precisely in a tissue-like mold, which holds them in place. They fill one inkjet cartridge with a material similar to human tissue, and another with cells, then alternate each in an alternating process, "printing" the cells in much the same way color photos are made.

REGENERATION

A MAGIC PULLET FOR DEAFNESS?

CHICKENS MIGHT one day unlock a cure for the hearing-impaired. That's the hope of scientists at Stanford University, who are studying the fowl to try to learn how they regenerate the tiny hair cells in their inner ear. Those cells convert sound into electrical impulses, which travel to the brain and produce hearing. Because chickens and other feathered creatures can regrow these cells after injury, there is no such thing as a deaf bird.

The researchers have figured out how to take embryonic stem cells



from mice, implant them into the ears of chick embryos, and coax them to differentiate into hair cells. They're working on perfecting a similar procedure for deaf humans.

MEDICINE

NO NEED FOR A SPOONFUL OF SUGAR

IT'S NOT JUST KIDS who don't much like to take their medicine. Surveys have found that lack of medication compliance among adults with chronic disease can run as high as 65%. That's a big reason why the drug industry is looking for better delivery methods than pills or injections. European researchers think they have found the ideal device: a fake tooth that can deliver the correct dose of medication for weeks.

The electronic device, called IntelliDrug, fits into two fake molars that can be implanted into a patient's jaw to the rear of—or in place of—existing molars. Saliva

enters a reservoir in the tooth through a membrane and dissolves the solid drug, which then flows through a small duct into the mouth, where it is absorbed by membranes in the cheeks.

Sensors monitor the amount of medication that is released and deliver the information to a tiny device that opens or closes the duct as needed. The tooth will also alert the patient through a remote device when the medication runs out or when the battery needs replacing. It holds about two weeks' worth of medicine.

IntelliDrug was designed by a consortium that includes the Fraunhofer Institute for Biomedical Engineering in Germany. Researchers there will test it in patients later this year, using a drug to treat narcotic addicts going through withdrawal.

—Catherine Arnst

DATA STORAGE

MESSAGE IN A GENETIC BOTTLE

HARD DISKS and memory sticks store huge amounts of information, but they can malfunction when exposed to heat and humidity. An article scheduled for the Apr. 9 issue of *Biotechnology Progress* suggests a more reliable way to preserve info: by inserting it in the DNA of a resilient strain of bacteria.

Scientists like the idea because DNA, which carries the instructions to replicate life, could store hundreds of times more data than current means—and of course bacteria pass the data from one generation to the next. The bacteria used in this experiment form a protective layer that helps them survive extreme conditions. And to reduce the risk that data could get corrupted by genetic mutation, scientists can encode copies at multiple locations on each DNA strand.

To test the technique, a team at Keio University in Tokyo encoded a message into the bacteria—"E=mc² 1905!"—in honor of Albert Einstein's theory of special relativity. They later reversed the process by sequencing, or reading, the entire DNA strand. Perfecting it for commercial use could take a decade or more, the scientists estimate.

—Kenji Hall





Shawn Baldwin
CEO, Capital Management Group

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Who Should Pitch, Angelina or Dylan?

A new breed of corporate consultants is attaching celebrities with ad campaigns

BURT HELM

HOW MUCH IS A CELEBRITY worth? Advertising agencies don't really know how to calculate the dollar value of star power. Hollywood talent agents are helpful: They represent the star's interests. So along comes a new breed of consultants promising corporate clients that they will take away some of the mystery. A half-dozen of these middlemen are already operating in Los Angeles, Las Vegas, and New York—among them Platinum Rye, Creative License, and The Brown Talent. Their pitch to marketers: All the information needed to cut the best deals is at our fingertips. They track market prices for the celebrities (accurate at least until the next deal). And they offer research to determine which stars are truly potential—and which are already celebrated. Work-

ing either on retainer or for a percentage of the total deal, the agencies negotiate everything from cameos at corporate events to appearances in national ad campaigns for brands such as Coors, Pepsi, Chevy, and AT&T.

One advantage these small outfits offer is that they are run by people familiar with the insular movie and music industries. "Think of scenes from [the HBO show] *Entourage*," says John Osborn, president and chief executive of BBDO Worldwide, an ad agency owned by Omnicom Group Inc. "If I were to pick up a phone and call an agency, I have no idea if I'm getting the right price, or talking to the right person. I need someone who can navigate this world."

Most important, the firms can sometimes shift the balance of power between big stars and big brands. It can be as simple as providing anonymity: When BBDO decided it wanted Lars Ulrich and James Hetfield of the band Metallica for an America Online advertisement, Platinum Rye initiated the negotiations with-

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appearance
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30 second
commercial
\$400K - \$600K

The Haul of Fame

Derek Jeter will play for you—for \$100,000. Here are rates for some other celebs:

Snoop Dogg RAPPER

PRIVATE CONCERT	\$100K - 200K
PERSONAL APPEARANCE	\$75K - 100K
30-SECOND COMMERCIAL	\$200K - 500K

Jessica Simpson SINGER, ACTRESS

PRIVATE CONCERT	\$400K - 800K
PERSONAL APPEARANCE	\$100K - 200K
30-SECOND COMMERCIAL	\$700K - \$1 million

Julia Roberts ACTRESS

UNIDENTIFIED TV COMMERCIAL VOICEOVER	\$1 million
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*All appearances are for 2-3 hours

Data: BusinessWeek

Ask Someone Why They Love Their BlackBerry

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Star Power

out once mentioning AOL. When talk agents and managers hear the name of a prominent brand, they can start "seeing dollar signs," Osborn says. "You need someone who can play hardball."

These firms are also introducing a new twist in that familiar Hollywood staple, the bidding war: Now it's celebrities who are doing the bidding. Molson Coors Brewing Co. is looking for a folksy song for its next ad campaign, according to people familiar with the search, but doesn't want to pay top dollar to license an existing tune like the likes of John Fogerty, Stephen Stills, or Bob Dylan. So Coors, its advertising agency DraftFCB, and Creative License are inviting major recording artists to submit a song on spec. The client gets the tune from a leading songwriter, and the artist gets a promotional boost, plus a paycheck. Which artists are considering it? John Fogerty, Stephen Stills, Bob Dylan, to name three.

MEASURING INFLUENCE

WHEN IT COMES to calculating a price for more traditional endorsements, the agencies can tap a wealth of information about recent deals. They also consider personal information, such as what causes interest the stars. When Creative License approached Sheryl Crow to promote her song *Every Day is a Winding Road* for Subaru last year, executives were in knowing Crow felt strongly about environmental issues. Representative showed her Subaru's low-waste manufacturing plants and talked about the company's commitment to being green. She agreed to the deal.

Measuring a celebrity's influence, of course, is as much art as science. To track stars' popularity, doesn't matter how good they are at persuading consumers to buy. Will Ferrell, for instance, is funny, and Angelina Jolie is beautiful, but a company might wonder whether anyone would take either endorsement seriously.

Davie Brown Talent, which is owned by Omnicom, surveys 1,000 respondents to calculate the relative appeal and influence of more than 1,500 celebrities. (Tom Ford and Oprah Winfrey are the two most influential.) While most people consider comedian Ferrell more likable than Jolie, she is the more persuasive, their research found. Jolie is currently earning some \$12 million, plus performance incentives, to be the face of John Knits International Inc. ■

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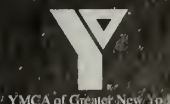
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Carl Edwards

The NASCAR driver needs endurance for every life-and-death second of a four-hour race. **BY BRIAN HINDO**

NASCAR DRIVER CARL EDWARDS' job is basically to sit in a car and make left turns all day. But few outside the sport realize just how grueling that can be. The drivers must navigate bumper-to-bumper traffic that's moving at 180 miles per hour while strapped into a seat that bakes north of 140 degrees on a hot day. Any mental lapses can result in death. "In a really hot, long race"—they usually last about four hours—"it pays off if you can be focused without being worn out physically," Edwards says.

It's not that he needs hyperdeveloped leg muscles to work the gas pedal. The NASCAR circuit is more of an endurance test. Drivers must execute precise, if repetitive, motions in their cars for long stretches under intense pressure. And they must do it amid the grind of a punishingly long schedule. The Nextel Cup Series, NASCAR's premier race series, has 36 events on Sunday afternoons from February to November, making it one of the longest seasons of any major pro sport. That's not to mention the drivers' nonstop city-hopping to midweek obligations for their corporate sponsors.

That's why Edwards, an affable 27-year-old who drives the No. 99 Office Depot Ford Fusion, works hard to maintain what's unquestionably the best-chiseled physique in NASCAR. Edwards was a dirt-track expert by his late teens and was always athletic, but as a kid he made fun of gym rats. About 10 years ago, he says, he got serious about fitness, on the



advice of NASCAR veteran Mark Martin, who's still racing on the Nextel Cup Series at age 48. These days, Edwards' routine includes plenty of cardio work—as much as an hour a day, typically biking or running—and weightlifting sessions, which last about half an hour, as many as four times a week.

Having hard bodies behind the wheel would be a big shift for NASCAR, a league whose roots run back to moonshine runners and cigarette sponsorships. At a gym set up in the infield of the Daytona International Speedway, where Edwards was practicing for the season-opening Daytona 500, Edwards demonstrated a typical workout session for *BusinessWeek*. "Ten years ago there might not even have been a gym at the track," says Fox Sports



FLOOR IT Edwards' two-part workout starts with an hour-long stationary bike ride in the morning and finishes with a session of strength training late in the day

announcer and former pit-crew chief Hammond, who credits Edwards helping to raise the profile of fitness in the sport.

Joined by fellow racers Jeff Burton and Jamie McMurray, Edwards went through a quick routine focused mostly on muscles. It consisted of multiple sets of lateral pulldowns, triceps curls, and s

Bumper-to-bumper driving at 180 mph can quickly take its toll





Race-Ready

Edwards does the following routine on Mondays, Wednesdays, Fridays, and sometimes Sundays. He'll get in an easy run or bike ride other days.

MORNING ROUTINE

① Warm up on a stationary bike (10 min.).

② Alternate three-minute bursts of maximum effort with three minutes of easy pedaling.

③ Repeat six more times, for a total of 42 minutes.

④ Cool down (10 min.).

press: Position a barbell on a rack at neck level; grasp and lift until the arms are fully extended overhead.

③ Do 10 reps on the bench press, 10 reps of hamstring exercises, such as curls, and finish the circuit with 10 leg presses (left).

④ Complete the lifting routine two more times, resting about five minutes between circuits, for a total of 30 reps for each muscle group.

5. Stretch after the routine (below, left).

EVENING ROUTINE

① Using free weights or weight machines, start with 10 reps on triceps and 10 reps on biceps.

② Do 10 reps of the military

Data: Carmichael Training Systems



thrugs (table). He had to be out in a
to get ready for practice laps around
ona's 2.5-mile track in a couple of
s. (Edwards would eventually finish
ce 23rd in a field of 43.)

st summer, Edwards began work-
with Dean Golich of Carmichael
ing Systems, a Colorado Springs
any founded by Lance Armstrong's
er, Chris Carmichael. "He was pretty
g," Golich says, "but I don't know if
s really fit." Together, they devised
ning routine that's more systematic

about when and how Edwards works out,
depending on where he is in his race
schedule. It's an approach more com-
mon to endurance sports athletes, such
as seven-time Tour de France champ
Armstrong.

The training routine varies according
to the demands of each track. For in-
stance, Edwards and Golich identify races
at tracks such as the Bristol Motor Speed-
way in Tennessee; it's a short, half-mile
track with steeply banked turns. Those
tight conditions create a lot of potential

for contact, which makes it the kind of
venue that's more taxing physically and
mentally on a driver. So in the week before
racing there, or sometimes two weeks in
advance, they'll dial back on the heavy lift-
ing and incorporate more rest, especially
during the hottest days of summer. "You
have to know how to train through some
races," Golich says, "and how to rest for
when you want to be ready to go."

That will be crucial for Edwards,
whose schedule is demanding even by
NASCAR standards. In addition to the
Nextel Cup he's competing in the sec-
ond-tier Saturday Busch Series races,
and he's doing a handful of Friday night
truck races. In all, he'll do about 75 races
this season. Plus, away from the track, he
recently started a record label, Back 40
Records, in his hometown of Columbia,
Mo. "I can't [call in] sick," he says. Nor
can he afford to be totally gassed at the
end of a race he has won—Edwards
punctuates each victory with a backflip
off his car. ■



BY JONATHAN SCHWARTZ

Harold Arlen's Beautiful Sorrow



SOMEWHERE OVER THE RAINBOW. Harold Arlen wrote that lovely, plaintive melody just before World War II. Starting in the 1930s and continuing through the early 1970s, Arlen built a catalog of melancholy spirit that has survived time. *Stormy Weather*, *Ill Wind*, and *I Gotta Right to Sing the Blues* still speak for a cantor's son born in the glacial February of 1905 in Buffalo. ♪ Arlen was a superb pianist and a marvelous singer. In fact, the first recording of *Stormy Weather*, made on

a 78 rpm in 1933, is his. He sang in vaudeville, in clubs, and at parties. Early on, he became a top-tier composer in the ranks of George Gershwin, Richard Rodgers, Irving Berlin, Cole Porter, and Jerome Kern. Some of the greatest lyrics of all time, written by Yip Harburg, Ted Koehler, Johnny Mercer, and others, were set to his music.

Harold Arlen was a droll and tender fellow, and a musician of exceptional candor. His songs speak of longing and loss. Consider *One for My Baby* or *Blues in the Night*. (Arlen used to call *Blues* one of his "tapeworm" melodies because it didn't have the usual 32-bar structure but stretched out, wormlike, winding through two or three melodies in the same song.) These are dignified works, honest music, and easily identified as Arlen's. They are midnight thoughts born of a solitude Arlen was unafraid to reveal.

Singers worldwide have paid their respects. From jazz artist Tierney Sutton, who sings two versions of *Get Happy* on her new CD, *On the Other Side*, to Broadway and popular singer Tom Wopat, who paid tribute on a 2005 all-Arlen album, vocalists embrace his music today. They have always taken unusual care with



ARLEN in the '60s

Arlen's work. Listen to Sinatra's *Ill Wind* on his album *In the Wee Small Hours* or Judy Garland's *The Man That Got Away*. You can almost reach out and touch Harold Arlen after identifying him in the first three mournful notes.

As a young man I wanted to embrace him. The closest I came was a brief moment in his home while he sat at the piano playing *Come Rain or Come Shine*. I stood behind him and gently rested my hands on his shoulders.

Jazz musicians can infuse their own feelings into Arlen's melodies, unlike, say, Jerome Kern's, which have a formality that doesn't invite improvisation (think *Ol' Man River*).

Not that sorrow is Arlen's only business. Think of *Get Happy* and *Have as the Day is Long*—my goodness, so affirmative stuff. *Get Happy* was the first song Arlen wrote, in 1930, when he was a rehearsal pianist. He doodled it out during a break. They're wonderful songs, but if you are really looking for Harold Arlen, lend your heart to *It Was Written in the Stars*, *Blues in the Night*, and all the others. Then you'll know him. To learn more, go to haroldarlen.com, the Web site run by his son, Samuel. ■

ALSO CHECK OUT THESE RECORDINGS:

FRANK SINATRA: *Last Night When We Were Young* on *Wee Small Hours* (1955) and *Blues in the Night* and *One for My Baby* on *Only the Lonely* (1958)

ELLA FITZGERALD: *It Was Written in the Stars* on *Ella Fitzgerald Sings the Harold Arlen Songbook* (1960)

TONY BENNETT: A set of Arlen songs—his *Live at Carnegie Hall* (1962)

NANCY LAMOTT: *Out Of This World/So in Love* on *Listen to My Heart* (1996)
SYLVIA MCNAIR: *The Morning After* on her *Come Rain or Come Shine—The Harold Arlen Songbook*, made with André Previn (1996)

Jonathan Schwartz hosts *High Standards* a channel on XM Satellite Radio, as well as weekend shows on WNYC-FM, a New York public radio station.



BY ROBERT PARKER

When Brunello Lives Up to Its Fame

BRUNELLO DI MONTALCINO may be Italy's most famous wine, but it frequently disappoints me. The wine, which hails from the Tuscan town of Montalcino and is made from the sangiovese grape, is aged in wood for at least two years. Often I find that it has too much tannin and musty oak and not enough fruit. Since selection is so important with Brunello, I asked my colleague Antonio Galloni for a list of his favorites from 2001, the best of the recent vintages. Among them are:

Euta La Fuga

92 points. This is a fresh, vibrant Italian displaying attractive notes of cherries, tobacco, minerals, and sweet toasted oak. Bodied and ample on the palate, it has an outstanding length as well as plenty of style, tannins, and understated yet expressive personality. It will be at its finest between 2011 and 2019. \$57

Piccolomini d'Aragona Rosso

91 points. This stylish, cask-aged offering has a floral, aromatic nose followed by a perfumed red fruit that blossoms on the palate with notable expansiveness, elegance, and finesse. It closes with fine tannins. While it can be enjoyed today, it will be even better in a few years and should keep for two decades. \$60

Pacenti

91 points. A midweight, ruby-hued brunello, the wine opens with a finely nuanced bouquet followed by a delicate core of fruit that bursts onto the palate with additional elegance, purity, and finesse as its silky tannins in the finish. Enjoy this wine any time between 2007 and 2011. \$70



Costanti

93 points. With its pure, cleanly articulated notes of cherries, tobacco, and underbrush, Costanti's brunello is a textbook example of sangiovese from Montalcino. It possesses excellent concentration, great length, nuanced transparency, fine, elegant tannins, and a note of warmth from the alcohol on the finish. This outstanding effort will benefit from a few years in the cellar, and it will keep for at least 20 years. \$75

Salicutti

94 points. This wine exhibits nuances of ripe fruit, earthiness, and tobacco with great

length on the palate, firm tannins, and a fine, long finish. Although full-bodied and intensely flavored, it also has an ethereal sense of lightness. This bottle needs to be cellared. Its anticipated maturity: 2011-2023. \$100

Cerbaiona

96 points. This superb wine opens with a profound, deeply expressive nose of licorice, tar, black cherries, and smoke that takes on new dimensions of complexity as it sits in the glass. Medium body, vibrant fruit, and noble tannins ensure that it still will be a magical wine in 15 to 20 years. \$125

Salvioni

95 points. One of the vintage's top wines, the Salvioni displays sweet dark fruit, notable concentration, a classic structure, and superb expansiveness as well as length. Despite its four years of cask aging, the wine boasts incredible freshness, richness, and vibrancy. It will be at its finest in two to three years and should keep for two decades. \$145 ■

Robert Parker is the world's most influential wine critic. Visit eRobertParker.com to see tens of thousands of tasting notes, buy his books, or subscribe to his newsletter, The Wine Advocate.

Wines rated from 96–100 are extraordinary; 90–95, excellent; 80–89, above average to very good. For more Parker picks, go to businessweek.com/extras.

The Insurance Inheritance

Creative new ways to fund multimillion-dollar policies can help you minimize taxes—and leave more money for your heirs. **BY DEBORAH L. JACOBS**

Wealthy families have long used life insurance policies as a way to minimize the impact of estate taxes as they pass money from generation to generation. One drawback: On a multimillion-dollar policy, premiums can run well into six figures. For those who didn't have the cash

flow, that used to mean liquidating investments or taking a loan, or for high-level executives, relying on employers. But now savvy lawyers have figured out ways for clients to finance multimillion-dollar policies without going to the bank. ↗ Such family-funded insurance strategies are on the rise because employers can no longer finance such policies. The Sarbanes-Oxley Act prohibits personal loans from public companies to their executives. These deals generally rely on an irrevocable life insurance trust, or ILIT. The trust buys the policy and holds the proceeds for the beneficiaries. Why the trust? If you own a policy that insures your life, the proceeds become part of your estate and possibly subject to estate tax. Not so with the ILIT.

The major challenge is to figure out how to get money into the trust so it can pay the premiums. How you do this will depend on the number of beneficiaries, the annual cost, and how much you have to contribute. For example, a \$10 million guaranteed universal life policy for a healthy 55-year-old man would cost about \$150,000 a year, says Mark Armstrong, a vice-president at ValMark Securities, an insurance broker in Akron. That's a relatively new and popular type of insurance that offers a guaranteed premium and death benefit, and a small cash value.

The best way to pay the annual bill will depend on your situation. Here are some options.

You have plenty of money and many heirs to whom you want to give it.

Oddly enough, the more beneficiaries of your ILIT, the easier it is to fund a policy. The goal is to contribute as much as you can to the trust without running up against gift tax. You can put in \$12,000 a year for each trust beneficiary; it's called the "annual exclusion." Your spouse can add in another \$12,000 for each beneficiary, too.

Those exclusions can give you a lot of bang for your buck. Take the case of a couple who used insurance to make gifts to their grandchildren go much further. They did this by setting up a trust that purchased a \$10 million policy on their son, a 38-year-old father of eight. To-

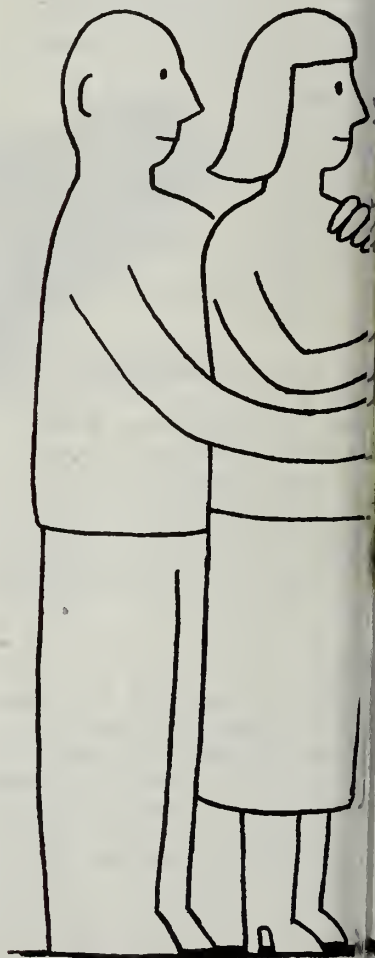
gether the couple put \$192,000 a year \$24,000 for each child—into the ILIT, says the couple's attorney, Jon Gallo, lawyer with Greenberg Glusker Field Claman & Machtinger in Los Angeles. The premium is \$50,000 a year, so the trust can invest the rest of the money and build a nest egg. That way, the premium will be paid by the trust when the grandparents are no longer around.

You don't have a lot of heirs, and paying that premium will trigger gift tax.

Don't give it, lend it. This loan to the trust must be documented, and you have to have an interest rate that's approved by the Internal Revenue Service. If you have the cash, you can lend directly. If you don't, you can borrow from a bank and then lend that money to the ILIT. The difference between the interest rate you pay the bank and the IRS-approved rate you get from the trust amounts to a tax-free gift to the trust.

You don't have a lot of cash, but your privately held business is flush.

This is a common situation among



reneurs. Lawrence Brody, a lawyer in Bryan Cave in St. Louis, recently arranged a loan from a woman's import-export business to an ILIT that bought \$100 million of insurance for naming her two adult children as beneficiaries. The business loaned the \$2 million to pay the premium. (The principal is due at her death.) To help the ILIT finance the yearly \$20,000 in interest payments, the donor, who's in her early 50s, will make annual gifts to the trust.

don't have a lot of cash, but you own property that throws off income.
The easiest move is to give the property to the trust. But if that would trigger tax, the property to the trust in exchange

for a promissory note with interest, says Stephan R. Leimberg, an insurance expert and president of Leimberg Information Services in Bryn Mawr, Pa.

You want to whittle down the sale price to make it easier for the trust to pay off the note. One way to lower the price is with a family limited partnership (FLP). (This popular estate-planning tool can serve a variety of functions, not just for ILITs.) Here's how it works: First you would put the property—assume it's publicly traded stock—into the FLP. Next, you would sell the ILIT a share of that partnership. Since few people outside the fam-

The goal is for the insurance trust one day to pay its own premiums

ily would want an interest in such a partnership, you're allowed to discount the stock's value by about 30%. The ILIT will receive partnership distributions that it can use to pay premiums.

You have only enough cash to pay part of the premium.

Get someone in the family to share the cost in what's called a split-dollar deal. You

give enough money to the ILIT to pay a portion of the premium. More precisely, it will be what a term life insurance policy would cost. Then a family member, known as the donor, pays the balance.

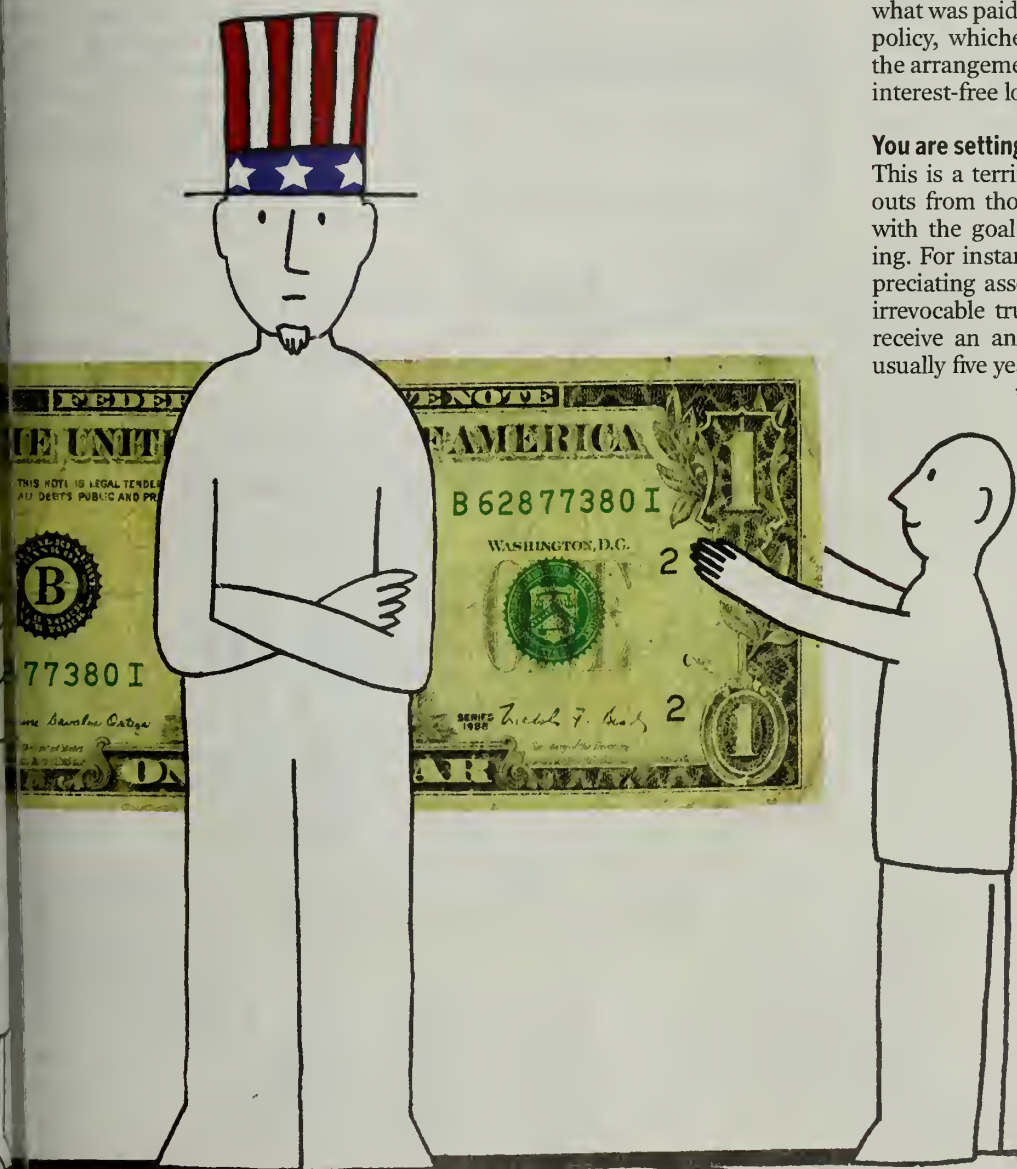
When you die, the trust and the donor typically share the proceeds. The donor, who gets paid first, must get back either what was paid out or the cash value of the policy, whichever is greater. Otherwise, the arrangement would be considered an interest-free loan subject to gift tax.

You are setting up other trusts anyway.

This is a terrific opportunity to use payouts from those trusts to fund the ILIT, with the goal of making it self-sustaining. For instance, suppose you place appreciating assets, such as stocks, into an irrevocable trust and retain the right to receive an annual income for a period, usually five years or less. If you're alive at

the end of the period, any property left in the trust (known as a grantor retained annuity trust, or GRAT) could pass to the insurance trust.

Before using a family deal to finance costly life insurance, ask about whether the arrangement can be undone if your circumstances change. Remember, too, that with any loan transaction, "at the end you have to repay the debt"—most likely out of the policy proceeds, warns Howard Zaritsky, a lawyer in Rapidan, Va. And that will leave less for those you intended to benefit. The upshot: Depending on financing technique, you may need to buy more insurance. ■



Pumping Up the Muni Advantage

Using financial engineering, hedge funds can hike returns to 8% or 9%. **BY NANETTE BYRNES**

HERE'S THE WAY YOU used to invest in municipal bonds: Buy \$50,000 of 30-year Texas highway bonds with a 4% coupon and collect interest of \$1,000 twice a year for 30 years. At the end, you get your \$50,000 back.

Here's a new way, at least for high-net-worth investors: Give \$1 million to a hedge fund. It will pool your money with others' to score \$100 million of bonds, chop up the interest payments, buy a derivative instrument to protect the investment, and *voilà*, turn the 4% into 8% or 9%—that's still tax-free.

This juiced-up style of investing is called muni-bond arbitrage (table). Until several years ago, investment banks and corporations did it mainly for their own accounts. Then the muni traders heard the siren song of hedge funds, too, and set up their own shops. Now there are about 25 hedge funds with an estimated \$3 billion in muni-bond arbitrage. At least three firms, GEM Capital, Rockwater Hedge, and Fortigent, are repackaging their services in funds of funds, some of which allow investors in with as little as \$100,000.

What has made this

style of investing suddenly so popular is the return it offers: It has earned 8% to 12% annually over the past few years, tax-free, on an investment with an AAA credit rating. "This is a time of great popularity" for the approach, says Keith Pagan, president of GEM Capital. "It is generating significant cash flow with infinitesimal credit risk." Still,

that popularity is starting to squeeze the returns to investors.

The hedge funds start with AAA-rated long-term bond issues, now paying around 4% a year. They take a good amount of that, often between \$50 million and \$100 million, and put the bond in a specially created trust. Using bonds as collateral, an investment bank creates two securities. The first, called the "A certificate" or "floater," is a money-market-like instrument on which the yield resets every seven days. The second part, the "B certificate," is held by the hedge fund and gets the 4% fixed rate. Today, the floaters generally pay interest of 3.2%. The hedge fund collects the difference between the 4.0% the municipality is paying and the 3.2% going to the money market fund.

This would be a terrible bet, of course, if the muni-bond yield curve ever "inverts"—in other words, if short-term rates were to exceed long-term, as rare on Treasury bonds do today. But it never has. That is because muni-bond investors, particularly money-market funds,

7 Over time, the return on the fund's investment is the difference between interest from the municipality and what is paid to the short-term investors. Recently, funds have been returning 8%-plus, tax-free, after fees.

High Rates, No Taxes

Municipal-bond arbitrage is an increasingly popular investment play that has become available to individual investors through hedge funds. The goal is to generate a high rate of tax-free income.

Here's an example of how it works:

1 A municipality issues a \$200 million AAA-rated 30-year bond.

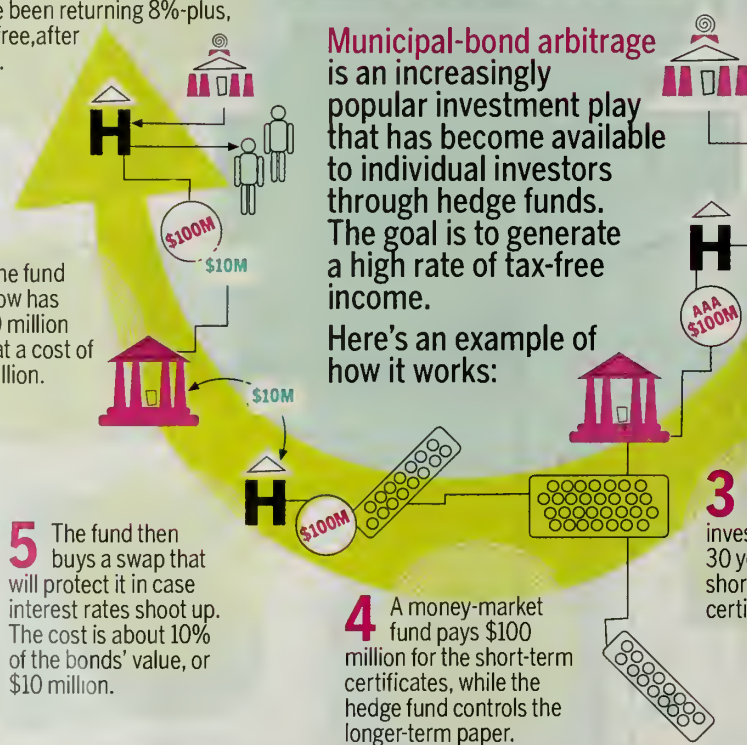
2 A hedge fund agrees to buy half those bonds, \$100 million worth.

3 The bonds are put in a trust, allowing an investment bank to split 30 years of payments into short-term and long-term certificates.

4 A money-market fund pays \$100 million for the short-term certificates, while the hedge fund controls the longer-term paper.

6 The fund now has a \$100 million asset at a cost of \$10 million.

5 The fund then buys a swap that will protect it in case interest rates shoot up. The cost is about 10% of the bonds' value, or \$10 million.



t short-term securities, but cities states issue mainly long-term because they use the proceeds to build long-lived assets such as roads and schools. The demand for short-term munis is so great that money-market funds will often pay for this sliver a price close to, or sometimes even equal to, what the underlying bond cost.

Since the trust must make the interest payments on the short-term bonds first, the hedge fund has to hedge against rates going higher. To do that, the fund buys an interest-rate swap from an investment bank. Different funds do this in different ways, but it's typical for that to cost about 1% or less than the total value of the bonds—say, \$10 million on \$100 million in 30-year bonds. Even though the fund gets 4% on the bonds and pays 3.2% on the short-term securities, the leverage allows them to earn a 1% plus return a year after fees.

POPULAR?

SPREAD, OR the difference between short-term and long-term rates, is what makes the arbitrage work. When the yield curve is steeper or flatter, there's a bigger gap between short and long rates, these hedge funds are even more rewarding.

The problem with all kinds of arbitrage is that the more people practice it the less profitable it becomes. And that is a concern now. Others say the growing popularity of this strategy has contributed to the flattening of the muni yield curve. At the end of the hedge fund demand for short-term bonds allows issuers to pay lower rates than they pay. At the other end, the funds risk flooding the market with so much short-term bonds that they have to pay higher rates to attract buyers.

Other factors could spoil these delicate deals. If the law were changed to allow tax rates, munis would become more attractive and their prices would rise. A complete loss of the tax exemption would have an even more devastating impact.

The worst time for muni-arb was after September 11, when investors rushed to Treasury bonds in a panic. Treasuries rose faster than munis, leaving the traders to pay more for their hedges. The arbs lost 6% a month but soon recovered. They don't get 8% or 9% tax-free with a little risk. ■

Stock Trades Without Borders

Investing on exchanges worldwide is finally becoming simple—and cheap. **BY LEWIS BRAHAM**



to select customers now and will be open to all in April.

Getting started is simple. If you're already an E*Trade customer, you can open a Global Trading account with a few clicks. It will pop up under the "Accounts" tab on the same page as all of your other assets. A few clicks later, you fund it by transferring dollars from your main account and converting them to the currency of your choice via the "Currency Exchange" tab. You're then ready to trade stocks in that currency.

The E*Trade site offers some overseas information resources, including Reuters news on global markets and individual companies. There's also a daily market-summary page for each bourse. The info on individual stocks is bare-bones, such as price and volume data and the price-earnings ratio. E*Trade officials plan to add more research tools and services.

EVEN CHEAPER

WHILE THE GLOBAL account is less costly than many others, it's not the cheapest. Interactive Brokers, which offers trades in 10 markets, has generally lower commissions. Interactive also has significantly lower costs for currency exchanges. E*Trade's fee for buying \$10,000 worth of euros is 1.25%, or \$125, but you wouldn't see it on your statement. The fee, which declines as the trades get larger, is rolled into the cost. At Interactive, the same euro purchase would cost just \$2.50, and it's indicated on the statement.

Still, Interactive lacks E*Trade's ease of use and breadth of products and services. For the investor looking to expand overseas, E*Trade's new account holds a particular allure. ■

BUYING STOCKS THAT TRADE only on foreign exchanges can be a hassle. Usually you have to call your broker, who will charge as much as \$100 for the trade, plus a fee to convert your dollars to euros, yen, or whatever currency you need. That's why many people wind up investing in foreign companies that have American depository receipts (ADRs), shares that trade on Wall Street in U.S. dollars. But that limits your choices to about 500 companies. Some world-class outfits, including Samsung and BMW Group, don't even have ADRs.

Well, get ready to broaden your investment horizons. On Feb. 20, E*Trade Financial launched its Global Trading account, which allows investors to trade about 14,000 foreign stocks online cheaply and easily. The Web-based broker is one of the first to offer direct, real-time access to exchanges in Canada, France, Germany, Hong Kong, Japan, and Britain. Commissions are in local currencies and work out to about \$20 per trade. The program is being offered

**A few clicks
convert your
dollars to
euros or yen**



BY GENE G. MARCIAL

WARREN BUFFETT'S BUY HAS BUOYED UNITEDHEALTH GROUP.

THE DRUG PIPELINE AT EPIX IS CATCHING THE EYE OF BIG PHARMA.

LJ INTERNATIONAL: RACING TO OPEN MORE STORES IN CHINA.

Buffett and UnitedHealth

WARREN BUFFETT stirred up investor excitement in UnitedHealth Group (UNH), the largest U.S. medical insurer, when his Berkshire Hathaway reported buying 1 million shares of UNH in a Feb. 15 filing with the Securities & Exchange Commission. Back in 2006, UNH tumbled from 63 in January to 42 on May 24 because of an options-backdating scandal that culminated in the ouster of CEO William McGuire. Afterward, the stock inched up as pros took advantage of the drop, but Buffett's purchase alone boosted it from under 52 to 54. Even before Buffett's move, Sarat Sethi of investment firm Douglas C. Lane & Associates had bought in when shares slid into the 40s. "UNH is a strong franchise that is way undervalued," says

Sethi, who puts its intrinsic value at more than 70. As either No. 1 or 2 in its markets, UNH is the low-cost operator with the highest margins among its peers, notes Sethi. He expects UNH to resume its share-buyback program once the options inquiry closes. Melissa Mullikin of Piper Jaffray (it did banking for UNH), who rates it "outperform," says the company "continues to be a strong cash-flow generator." In 2006 it had \$6.5 billion in adjusted operating cash flow, more than 1.5 times net income, she says. For 2007, Mulliken sees profits of \$3.40 share on revenues of \$78 billion; for 2008, she expects \$3 on \$85.8 billion.

ON THE ROAD TO RECOVER

STOCK PRICE (DOLLARS)



BOLD MOVES



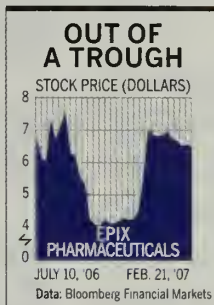
2-0 on the road.

(Ford Fusion beat Camry and Accord twice.)

ROAD&TRACK

What Glaxo Saw in Epix

WHEN EPIX PHARMACEUTICALS (EPIX), a small biotech, signed up on Dec. 12 with GlaxoSmithKline for clinical trials of a drug for Alzheimer's and three other products, its stock leaped from 5.52 to 7.38 in two days. It has since eased to 6.49, but some think it will more than double in a year. The deal gave Glaxo 14.6% of Epix. Other funds focused on biotechs also took big positions, including OrbiMed Advisors, the No. 2 investor, with 11.5%. Glaxo paid Epix an initial \$35 million, with a potential of rising to \$1.2 billion in milestone payments. "Its pipeline of internally developed compounds makes Epix attractive at current prices," says George Fulop of Needham, who has a 12-month target of 13. Max Jacobs of J.P. Morgan Capital, which owns shares, says Epix could hit 20 in two years based on the potential of its products.



Sparkling Hong Kong Jeweler

OME OF THE SHINE at top U.S. jewelers such as Fred Meyer Jewelers and Helzberg Diamonds; at specialty stores Zales and Kay Jewelers; and at Wal-Mart and Target comes from little-known LJ International, a maker of

quality jewels in Hong Kong. Its stock, which trades on the NASDAQ with ticker symbol JADE, has shot straight up from 4.20 in mid-December to 11.03 on Feb. 21. With its retail and wholesale business growing fast, LJ International plans to increase the number of stores in China to at least 100 before the 2008 Olympics opens, says Chairman and CEO Yu Chuan Yih. Right now it has 45 outlets in China, Hong Kong, and Macau, and it uses a variety of designers in China. Albert Lee of Maxim Group, who rates LJ International a buy, raised his earnings estimates and 12-month target price to 12 after posting better-than-expected fourth-quarter results. "My 12 target may still be inexpensive," he says, based on his 2007 earnings forecast of 57¢ a share on sales of \$154.7 million, compared with 2006's 33¢ on \$123 million. For 2008, he expects to see 84¢ on \$192 million. Gordon McBean of Roth Capital Partners says LJ's wholesale and retail business present "solid growth prospects as more U.S. and European retailers look to low-cost, high-quality makers overseas." LJ is positioned to benefit from the strong, growing demand in China, he adds. ■

A RUNUP FOR THE OLYMPICS



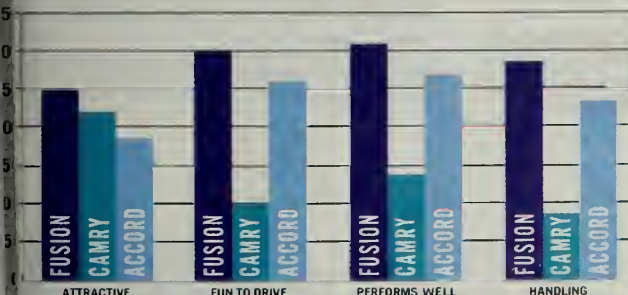
BusinessWeek.com

ONLINE: Gene Marcial's Inside Wall Street is posted at businessweek.com/investor at 5 p.m. EST on the magazine's publication day, usually Thursdays.

Note: Unless otherwise noted, neither the sources cited in Inside Wall Street nor their firms hold positions in the stocks under discussion. Similarly, they have no investment banking or other financial relationships with them.

only in Los Angeles, Camry and Accord got a second chance to prove themselves at the all-wheel-drive Ford Fusion. *Road & Track* invited car enthusiasts to test the midsize sedans back-to-back-to-back. And just like a month earlier, when *Car and Driver* hosted the same kind of competition in Washington, DC, drivers praised the handling, performance and styling of the Fusion to the other two cars. So the imports in their own backyard. If that surprises you, find out what driving drivers on both coasts have already discovered.

Get out yourself. Visit a Ford Dealer or go to fusionchallenge.com.



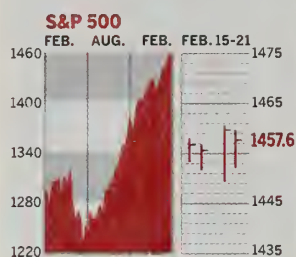
from 400 drivers in L.A., who were asked if the cars were attractive, fun to perform well and handled with precision. "Yes" responses scored one point. "No" responses scored zero. The results speak for themselves.

FUSION

CHALLENGE



STOCKS



COMMENTARY

The markets looked ready to rocket to new highs before petering out at the end of the week, as the Fed's worries over inflation dampened investors' spirits. Profits at Wal-Mart jumped this quarter, pushing shares up 4%. News that Spanish megabank BBVA plans to gobble up Compass Bancshares boosted the stock of the regional player by 13%.

Data: Bloomberg Financial Markets, Reuters

U.S. MARKETS

	FEB. 21	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
S&P 500	1457.6	0.2	2.8	13.6
Dow Jones Industrials	12,738.4	0.0	2.2	15.1
NASDAQ Composite	2518.4	1.2	4.3	11.3
S&P MidCap 400	866.7	1.3	7.7	12.2
S&P SmallCap 600	422.5	1.8	5.6	12.5
DJ Wilshire 5000	14,723.0	0.4	3.6	14.0

SECTORS

	FEB. 21	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
BusinessWeek 50*	824.7	0.2	3.3	8.5
BW Info Tech 100**	451.8	0.3	1.0	17.5
S&P/Citigroup Growth	667.7	0.2	2.3	10.0
S&P/Citigroup Value	788.7	0.1	3.2	17.3
S&P Energy	446.5	-1.2	-2.0	11.3
S&P Financials	508.1	0.3	2.6	17.1
S&P REIT	221.1	0.9	11.2	32.4
S&P Transportation	279.8	-0.6	6.1	6.9
S&P Utilities	193.3	-0.6	3.6	18.1
GSTI Internet	211.1	0.6	5.7	9.5
PSE Technology	911.0	0.5	4.0	5.2

*March 19, 1999=1000 **February 7, 2000=1000

GLOBAL MARKETS

	FEB. 21	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
S&P Euro Plus (U.S. Dollar)	2056.5	-0.6	3.4	2.2
London (FT-SE 100)	6357.1	-1.0	2.2	8.1
Paris (CAC 40)	5694.6	-0.5	2.8	1.1
Frankfurt (DAX)	6941.7	-0.3	5.2	1.1
Tokyo (NIKKEI 225)	17913.2	0.9	4.0	1.1
Hong Kong (Hang Seng)	20,651.4	2.2	3.4	3.2
Toronto (S&P/TSX Composite)	13,330.3	1.0	3.3	1.1
Mexico City (IPC)	28,716.0	0.6	8.6	5.1

FUNDAMENTALS

	FEB. 20	WEEK AGO	YEAR AGO
S&P 500 Dividend Yield	1.75%	1.76%	1.78%
S&P 500 P/E Ratio (Trailing 12 mos.)	18.0	17.8	18
S&P 500 P/E Ratio (Next 12 mos.)*	15.5	15.3	15
First Call Earnings Revision*	-2.62%	-3.08%	-2.00%

*First Call

TECHNICAL INDICATORS

	FEB. 20	WEEK AGO	YEAR AGO
S&P 500 200-day average	1339.9	1337.0	Positi
Stocks above 200-day average	81.0%	80.0%	Negati
Options: Put/call ratio	0.80	0.76	Positi
Insiders: Vickers NYSE Sell/buy ratio	7.26	6.27	Negati

BEST-PERFORMING GROUPS

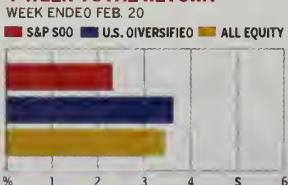
	LAST MONTH %	LAST 12 MONTHS %
Constr. Materials	26.0	Tires & Rubber 75.3
Steel	19.8	Steel 71.8
Constr. & Farm Mchnry.	15.4	Constr. Materials 57.7
IT Consulting	15.3	Department Stores 47.2
Personal Products	13.2	Divsfd. Metals & Mining 44.8

WORST-PERFORMING GROUPS

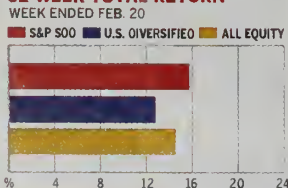
	LAST MONTH %	LAST 12 MONTHS %
Spclzd. Cnsmr. Serv.	-9.1	Homebuilding
Food Wholesalers	-4.9	Education Services
Biotechnology	-4.0	Gold Mining
Broadcasting	-4.0	Electric Mfg. Svcs.
Systems Software	-3.9	Spclzd. Cnsmr. Serv.

MUTUAL FUNDS

4-WEEK TOTAL RETURN



52-WEEK TOTAL RETURN



Data: Standard & Poor's

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Real Estate	6.2	Real Estate	36.0
Small-cap Growth	5.5	Pacific/Asia ex-Japan	35.3
Latin America	5.1	Latin America	30.9
Technology	5.0	Europe	28.4
LAGGARDS		LAGGARDS	
International Hybrid	2.0	Health	5.8
Health	2.1	Japan	7.0
Domestic Hybrid	2.1	Natural Resources	7.3
Natural Resources	2.3	Technology	7.8

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
DireXn. Mid Cap Bull 2.5X	13.8	Dreyfus Prem. Grtr. China A	71.7
DireXn. Sm. Cap Bull 2.5X	12.7	Oberweis China Opport.	62.1
ProFunds Internet Inv.	12.4	E.I.I. Int. Property Instl.	60.1
ProFunds UltraMid Cap Inv.	11.0	Old Mut. Clay Finlay Ch. A	59.9
LAGGARDS		LAGGARDS	
DireXn. Sm. Cap Bear 2.5X	-11.4	DireXn. Emrg. Mkts. Short	-40.7
ProFds. USh. Mid Cap Inv.	-9.8	DireXn. Dev. Mkts. Bear 2X	-36.2
Rydex Dyn. Russell 2000 H	-9.1	DireXn. Sm. Cap Bear 2.5X	-28.4
ProFds. USh. Small Cap Inv.	-9.1	American Heritage Grth.	-25.0

INTEREST RATES

KEY RATES

	FEB. 21	WEEK AGO	YEAR AGO
Money Market Funds	4.86%	4.86%	
90-Day Treasury Bills	5.17	5.15	
2-Year Treasury Notes	4.84	4.87	
10-Year Treasury Notes	4.69	4.74	
30-Year Treasury Bonds	4.79	4.83	
30-Year Fixed Mortgage †	6.14	6.19	

† BankQ

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BONO	30-YR.
General Obligations	3.82%	4
Taxable Equivalent	5.46	5
Insured Revenue Bonds	3.96	4
Taxable Equivalent	5.66	6

THE WEEK AHEAD

DURABLE GOODS ORDERS

Tuesday, Feb. 27, 8:30 a.m., EST
» Durable goods orders probably retreated 2.8%. That's the median forecast of economists surveyed by Action Economics. Orders in December jumped 2.9%.

GROSS DOMESTIC PRODUCT (REVISED)

Wednesday, Feb. 28, 8:30 a.m., EST
» Fourth-quarter real GDP is expected to be cut to an annualized growth rate of 2.5%, due mostly to a smaller-

than-expected rise in inventories. The initial increase was 3.5%.

NEW-HOME SALES

Wednesday, Feb. 28, 8:30 a.m. EST
» New-home sales are forecast to have remained virtually unchanged at an annual rate of 1.1 million in January from a pace of 1.12 million in December.

PERSONAL INCOME

Thursday, Mar. 1, 8:30 a.m., EST
» Personal income most likely grew 0.3% in January, after a 0.5% gain in

December. Consumer spending, most likely rose 0.4%, following a solid 0.7% rise in the prior month.

PURCHASING MANAGERS' INDEX

Thursday, Mar. 1, 10 a.m., EST
» The Institute for Supply Management's February factory activity index likely edged up to 50%, from 49.3% in January.

CONSTRUCTION SPENDING

Thursday, Mar. 1, 10 a.m. EST
» January building outlays probably held steady after falling 0.4%.

The BusinessWeek production improved to 293.4 for the week ended Feb. 10, an 8.5% gain from year ago. Before calculation of four-week moving average, the index edged up to 294.8.

BusinessWeek .com

For the BW50, more investment data, and the components of the production index visit www.businessweek.com/extras

Company Index

This index gives the starting page for a story or feature with a significant reference to a company. Most subsidiaries are indexed under their own names. Companies listed only in tables are not included.

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U.S. Environmental Protection Agency

In Search of Joe Sixpack

THE AVERAGED AMERICAN Surveys, Citizens, and the Making of a Mass Public
By Sarah E. Igo; Harvard University Press; 398pp; \$35

With all of the data now available on consumers' wants and needs, it's hard to imagine that less than a century ago market research consisted of little more than knowing the number of widgets your business sold in Muncie. Then, in the years after World War I, commerce was revolutionized by the dawning

of modern social science research and scientific polling techniques. A fascinating glimpse of the upheaval that forever altered the way Americans see themselves, sell products, and operate election campaigns may be found in *The Averaged American: Surveys, Citizens, and the Making of a Mass Public* by University of Pennsylvania historian Sarah E. Igo.

It was a rocky road to social transformation. In the early years of scientific research, Igo writes, it took a lot of work "to persuade business owners...that collecting information about their customers' buying habits was worthwhile." Many did not believe that citizens would answer prying questions about personal habits or political views from strangers knocking on their doors. And a large number of skeptics, she observes, did not "trust the assembled answers as either trustworthy or true."

Igo, a rising star among American historians, presents detailed analyses of three milestones in the emerging field of survey research: Robert and Helen Lynd's best-selling Middletown studies of 1929 and 1937, which dissected the lives of residents of an unnamed, average town in Middle America (Muncie, Ind.); the creation by George Gallup and Elmo Roper of the first public opinion polls in 1935; and Alfred Kinsey's shocking sexual-behavior reports of 1948 and 1953.

The key for the survey-research industry was defining "the average American." That's the everyman (yes, in those days, marketers wanted to appeal to "the man of the house") who will buy your products or vote for your candidate. As *Newsweek* noted in 1947, "a shadowy figure [is] beginning to emerge...American majority man."

But, as Igo wisely notes, the search for the average American intentionally excluded large swaths of the population. The Lynds' Middletown research excluded African Americans and immigrants, and Kinsey limited his sexual studies to Caucasians. Early polling often

undersampled the poor, racial minorities, immigrants, Southerners, and others seen as less likely to purchase consumer goods or vote. "Even if [the portrait] was never particularly accurate or representative," Igo writes, the new typical Americans played "a vital role in consolidating the [concept of a] national public."

The world of surveys spawned businesses that were designed to explain these average Americans and "the public" to those who would buy the data, from politicians to companies. *Business Week* in 1934 called the Lynds' work "a godsend to marketers." Gallup saw similarities in how people think "from politics to toothpaste." Roper predicted that the science of polling would become "a veritable gold mine if we could learn fast enough how to use it in all of its ramifications."

It did become a gold mine for Roper, as he signed up companies that were eager to sell their products to average Americans. Among the first to embrace the new way of doing business: Ford Motor, Standard Oil, the American Meat Institute, the National Broadcasting Co., RCA Victor, and the Spiegel catalog company.

As the polling business became more sophisticated, Gallup and others began to sort gender, class, and geographical differences to help clients appeal to groups once "routinely ignored," including housewives, Southerners, and blue-collar workers. With the coming of the civil rights movement

and the sexual revolution of the 1960s, "pollsters recalibrated their strong majoritarian frame, detecting new significance in how men and women, young and old, Latinos and Asian Americans assessed presidents and purchased differently." Niche markets and microtargeting became buzzwords on Madison Avenue.

Gallup and Roper and Kinsey, oh my

At the dawn of the 21st century, survey research is continuing to evolve. Using state-of-the-art technology, pollsters examine brain scans to determine which product pitches or political platforms cause flashes of neural activity. The growth of Internet polling has raised debates over the scientific validity of Web-based survey techniques.

Polling, once considered a scandalous invasion of privacy is now an accepted practice. More than 20% of Americans were polled at least once in the past year. As Igo aptly concludes, "we will continue to live in a world shaped by perceived through, survey data." ■

—By Richard S. Du





The Cult of Innovation

flood of recent articles, books, podcasts, and blogs offers the following advice to businesses in today's global marketplace: To remain competitive, you must innovate, innovate, innovate. You must spread innovation throughout your company like fertilizer, the experts exhort. And everyone within the organization—custodians and executives alike—had better

race innovation lest they imperil the company itself. The word is everywhere, becoming this generation's "efficiency" or "Total Quality Management." Indeed, *BusinessWeek's* latest supplement calls itself in: *Inside Innovation*.

It's not hard to see where this deification may lead: innovation for innovation's sake. For proof, simply walk down the aisles of a supermarket and take note of all the "New and Improved!" products. What it gets us, in other words, is purple ketchup and Crystal Pepsi—products that no one needs and few actually desire.

The problem is a widespread misunderstanding of the true meaning, or benefit, of innovation. Innovation is traditionally understood as a combination of insight and invention, with

the former being the "Aha!" moment and invention being the latter. It takes a company's muscle to make it happen. This is all well and good, but one crucial aspect of the definition is missing: the ability to judge the inspiration and determine whether it is worthwhile to spend the company's resources on the invention. Without this element, innovation is just The New, and new isn't always better. It's a louder sizzle, not a juicier steak. For innovation to be truly important, it needs to resonate with consumers. Insights need to be derived from the real needs and desires of people, not simply the company's feeling that it needs to innovate.

The reason we covet certain objects has little to do with how "innovative" they are. Instead, we covet certain products because they meet our needs, or they are needs we didn't know we had. The fact that so many of us love our iPods, the No. 1 example cited by innovation gurus, isn't because they are innovative. We love them because they allow us to listen to music and manage our music collections as never before. TiVo offers a similar benefit for television viewers. Finally, I can subscribe to my favorite TV shows and watch them at my leisure. I didn't know I even needed—no, needed—TiVo until I had it. In other words, it has been a blessing for me and for millions of other consumers. Innovation-obsessed companies can fall into another trap: that of discarding or neglecting perfectly fine products to make room for new ones. Some products, especially breakthrough

products, often take time to reach mass adoption. (Remember when critics claimed "iPod" stood for "Idiots Price Our Devices?") If you are constantly seeking the new, then the established, no matter how useful or usable it is, will seem dull by comparison, in need of sprucing up. But this is false innovation, driven by the company, not by customer needs.

What's needed isn't always the new or the unique, and it certainly isn't always more, as in more features, more gizmos, more newness. Sometimes it's less. Nintendo's Wii, for instance, has far fewer features than Sony's PS3, and yet the Wii is such a joy to use that it has been far outselling the PS3. So, sometimes it requires answering the simple but

all-important question: Do people really need this? Or, more important, would this product enrich someone's life?

This is where Design comes into play. As a designer, I'm pleased by the recent move by business to involve designers in the innovation process. I'm worried, however, that Design (with a capital D, which is more than just product styling) will conveniently be labeled as innovation, only to be relegated to the bench once the I-trend has subsided, as all trends do.

Design as a discipline and as a way of working has so much more to offer—methods for research, brainstorming, conceptualizing, making products, and, yes, thinking.

Innovation, at least in its popular usage, has none of these. Most important, it has no history, only a present and a future: the never-ending quest for the new and the unique, and, only occasionally, the better. But without context for consumers, the cult of innovation will eventually be forgotten along with any important lessons learned, including the most important one: just because you can do something doesn't mean you should. Rather than simply making novel products and services, we should strive to make better, more meaningful ones. Now that would be a true innovation. ■

**Consumers
don't need
purple
ketchup or
Crystal Pepsi.
They need
meaning**

Dan Saffer is an interaction designer at San Francisco design and user-experience consultancy Adaptive Path.



Neeleman Explains Himself

AND YOU THOUGHT you've had some bad weeks. In the space of six days, CEO David Neeleman saw JetBlue's customer-friendly image get buried by an ice storm in New York that turned the airline into bedlam central. Neeleman has since been making almost Japanese-style gestures of corporate contrition, issuing a Customer Bill of Rights and even apologizing on the *Late Show with David Letterman*. I talked with Neeleman about how JetBlue can rebuild its once-loyal, almost fanatical, following.

Where is JetBlue in terms of recovering?

We're back to normal, but no one's resting and...I'm just like poking everybody as hard as I can, saying, "Ice storm's coming tomorrow, everybody. Ice storm's coming. How do we make sure this never happens to us again?" And I'm convinced if it happened tomorrow, we would be maybe as good as we have been in the past on snowstorms. But I am convinced if it happens two weeks from now that we're going to be 10 times better than we've ever been. And if it happens, let's see, Apr. 1, it's going to be amazing how we'll be able to deal with it.

Mm-hmm. So tell me again, how did things go so wrong?

[Valentine's Day] was all messed up, and it was really difficult because ice was just caking [JFK] Airport. At that point, we had to cancel flights. And with 250 flights with an average of 5 crew members per flight, we had 1,200 crew members who were displaced from their next line of flying. Now you have planes and people displaced and you have to figure out...how do I put Humpty Dumpty back together again. So we canceled more flights on Thursday and tried to set up for Friday. At that point, we had started running behind, and things were becoming more complicated and it was more difficult to find crew members.... And when one thing, like the crew services thing, gets overwhelmed, it just has a trickle-down effect.

Have you reached out to other executives or management gurus for advice?

Well, no, I haven't. Certainly, there was a question of, where did we get our crisis management training from and who helped me decide what to do. Basically, [it was] nobody. I mean, we've been through similar crises before...and it's a pretty simple formula. When you mess up, you just apologize



and fix what it was that you did wrong and explain what won't happen again.

Did you consider stepping down?

No. Absolutely not.

Do you think this crisis was a failure of training, a lack of contingency planning, or a flawed business model?

Lack of a contingency plan. When you run as good as we run, I don't think you're as good at [crisis management].

How damaged is your brand?

I'm getting a lot of e-mails, obviously—a lot of supportive e-mails but a lot of "You jerk, you ruined my vacation" e-mails.

Who will ultimately take the fall for how this was handled?

Our president is also our chief operating officer, and we already decided before this event to bring in a really strong COO. One thing you have to keep in mind is that we've been the best airline for the last seven years, so we had a really good event, disappointed a lot of people, and hurt our brand, but that doesn't mean that our people aren't good...and I'm a bit reluctant right now to throw them all out. But I do think we need additional bench strength.

Is there any reason to believe that all this is going to have impact on more than the first quarter?

Well, I hope not. I mean, I don't know.

Maria Bartiromo is the anchor of CNBC's Closing Bell.



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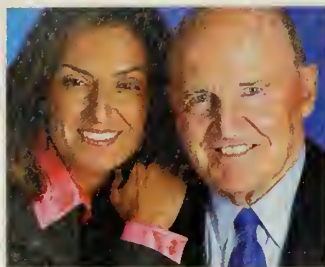
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Ideas **The Welch Way**

BY JACK AND SUZY WELCH

The Blame Game — Forget It

How do I protect my entrepreneurial team from corporate? It's always trying to micromanage us from above, handing down everything from the marketing spend to inventory targets. The interference really hurts our speed and morale.

—Anonymous, San Francisco

You'd think the cliché about corporate stiffies showing up and smarmily announcing, "We're here to help you," would be dead by now, but it still happens all the time, and it's still god-awful. When you're on the front lines, fighting for customers, wrestling with suppliers and distributors, and all the while deflecting competition from every direction, the last thing you need is senior management stuffing you with pie-in-the-sky targets. It's enough to make you turn to your great little entrepreneurial team and scream.

And that is exactly what you cannot do. Ever, ever, ever.

Look, corporate is not the enemy, even though it can too often seem that way, with outsize demands or out-of-touch targets. It's just that corporate has a job to do, and sometimes it actually knows some things you don't. On its best days, then, corporate is not trying to micromanage you. It's trying to balance your needs with the needs of other parts of the organization. It's trying to manage short-term results and long-term investments. It's trying, basically, to make the whole greater than the sum of its parts, a worthy cause underneath it all.

But even if corporate's intentions are good—beware. You as a leader must relentlessly shield your team from its interference. To do otherwise is a fast track to losing your team's confidence and respect. Every time you groan that "Jim says we have to cut 10% of inventory," or complain that "Helen is forcing me to get rid of Steve because he's so bad at meetings," you make yourself look like a marionette. In fact, you actually make yourself a marionette. That's career suicide for you and not much better for your team. Very soon, instead of looking to you for direction, your people will be looking around you, searching for signs from the "real boss." If you think speed and morale are taking a hit now, watch out.

So, back to your problem—which happens to be extremely common. Obviously, we're not going to suggest you become a corporate apologist, trying to sell every edict to your people as if it were ice cream. By all means, push back hard on behalf of your business. Challenge nonsense

**Using
corporate
as a crutch
is just bad
leadership**

targets. Negotiate for resources. But keep that process behind closed doors, and when it is over, whether you've made gains or not, own corporate's final decision as your own. Take it to your people as your plan.

Remember Jim's inventory cut? Say he won't budge, even after you've made the case that it's stupid in your business' high-demand environment. At that point, you need to buck up and move on. Get with your team and figure out a way to deliver the additional net income or cash that corporate wants without whacking inventory levels and disappointing customers.

As for poor Steve, whom Helen wants fired—that's another case for you to own. If Steve's a solid contributor instead of pulling the trigger while blaming Helen, quit work your tail off to improve his presentation skills. In other words, make it your job to manage the interface between corporate and your team. And when corporate makes that interface thorny, don't share your pain—absorb it.

If that sounds a bit unnatural, that's because it is. It is perfectly human for managers to want to blame "up there" for how hard it is "down here." But real leaders can't do that. And they don't.

I just said no to an excellent business opportunity because I didn't trust the person in charge, even after he doubled the salary to keep me from walking. I'm still having pangs of regret because I was passionately in love with the product. Did I do the right thing?

—Wendy Garfield, New York

Double the money is very nice, we'll give you that. But the facts are you just cannot work long with people you don't trust, because trust is the foundation for everything good that happens in organizations, like candor, collaboration, feedback, debate, and creativity.

Now, there certainly are times when you will join a company not because you particularly like the people but because you love the product so passionately, to use your phrase, or because it just offers so much career opportunity. But trust is different from like, and the boss is different from people in general. You saw a red flag and you heeded it. Stop feeling those pangs and feel good about your call. ■

Jack and Suzy Welch look forward to answering your question about business, company, or career challenges. Please e-mail them at thewelchway@businessweek.com. For their weekly podcast go to www.businessweek.com/search/podcasting.htm.

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BY ROBEN FARZAD & DAVID HENRY (PAGE 34)

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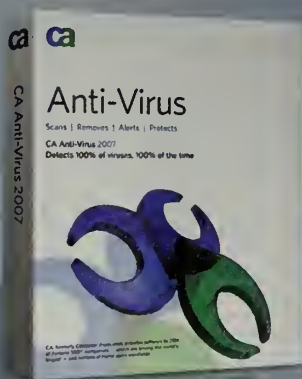


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BusinessWeek (ISSN 0007-7135) Issue number 4025, published
except for one week in January, July and August, by The
McGraw-Hill Companies, Inc. Executive, Editorial, Circulation, and
Marketing Offices: 1221 Avenue of the Americas, New York, N.Y.
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Subscriber Service: Send address changes to BusinessWeek, P.O. Box 8418,
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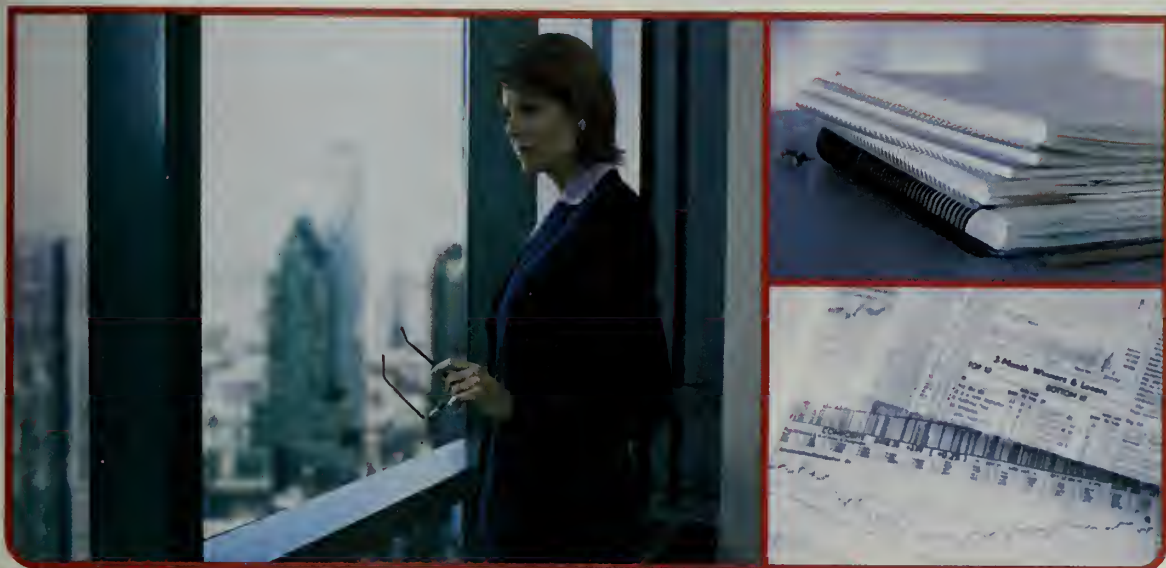
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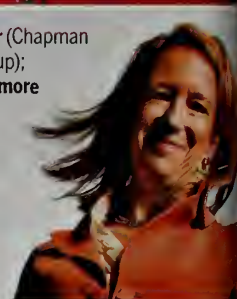


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Left: Myrtle Potter (Chapman Development Group); above: Nina McLemore (Nina McLemore clothing); right: Elizabeth Funk (CML Global Capital)

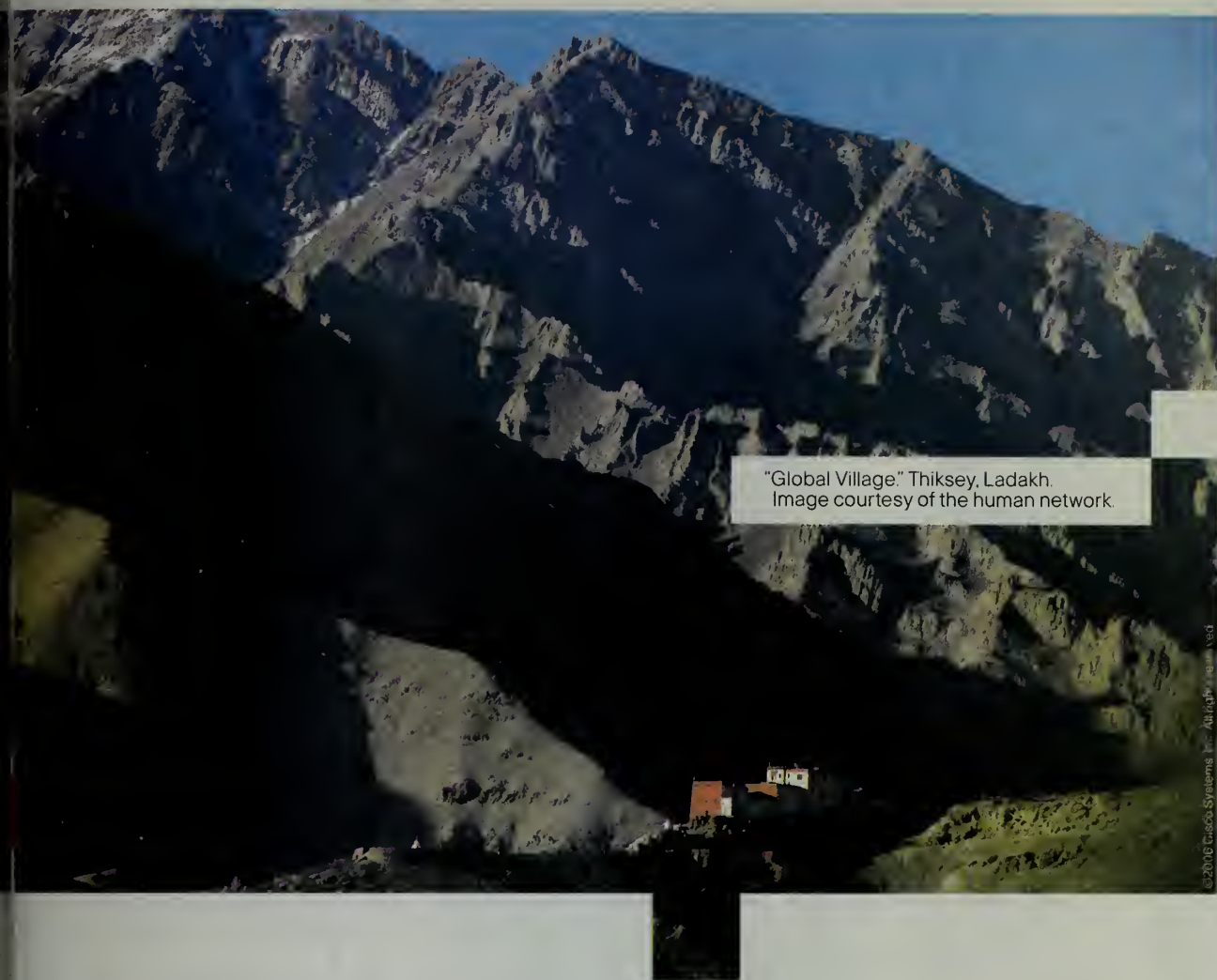


They Do It Their Way

The dearth of women in high-ranking positions in American business has long been a subject of concern and debate. The reasons are many, of course, including work-family life conflict and other barriers to advancement. But an elite group of corporate achievers is leaving for another reason: These women want to do things their way. A BusinessWeek.com **Special Report on Women Entrepreneurs** looks at 18 women who gave up jobs in large corporations to start a company or take the helm of an existing business. Get their **candid advice for would-be entrepreneurs** in our audio slide show. You can also catch a video panel discussion on the myths and realities of the work-life balance. And be sure to tune in to Making the Leap, our **new weekly series of podcasts** with some of the featured entrepreneurs. We also welcome e-mail questions for this cadre as well, as your suggestions of other women who have left the world of big business to go out on their own. We'll profile a selection of your picks online. Go to www.businessweek.com/go/07/womenentrepreneur for all this and more.

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JP Front

"I don't think you can call it a perfect storm... but certainly the market was in need of a break."

—Johnson Research Group CEO and Chief Market Strategist Chris Johnson on the 3.3% decline in the Dow Jones industrial average on Feb. 27

EDITED BY DEBORAH STEAD

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The Sweet Smell of Success

THE DAY after the Oscars, and additional celebrity wags are gaga over Scorsese, Gore, and what was hanging around Meryl Streep's neck? Jay Levin, however, wants to know the condition of Anna Nicole Smith's body, as her family squabbles over her burial.

Levin is managing editor of **TMZ.com**, a cheerfully sleazy celebrity site that, feared by viewers, has zoomed past sites from *People*, *E!* Entertainment, and *Entertainment Weekly*. The site generates more than 6 million unique monthly users, nearly double the number of a year ago, according to comScore and a Metrix.

Now TMZ, a joint venture of Warner units AOL and TV production studio Telepictures, is planning to bring its take-home paparazzi videos to TV. It will go up against mainstays *Access Hollywood* and *Entertainment Tonight*. The show will air in about 80% of the U.S., including Fox Entertainment's

35-station group in the big markets.

The competition isn't quivering. "We know our mission—to get big exclusive interviews and solid Hollywood entertainment news," says Rob Silverstein, executive producer of *Access Hollywood*, whose ratings rose 10% this year. "Others can dip their toes into what will get them quick ratings."

TMZ's down-and-dirty celeb scoops are big on the Web. Will they play on TV?

But TMZ hopes advertisers take note of its audience, which is younger than the competition's 45-ish median viewer age. Working from a nondescript Burbank warehouse, Levin's 25-person staff has been generating buzz since it broke Mel Gibson's drunken anti-Semitic meltdown last summer. TMZ also led the pack in reporting comedian Michael Richards' racist club rant and Britney's return to rehab. Among the site's regular



BARE TRUTH
Following Britney Spears

advertisers: Verizon, Blockbuster, and J.C. Penney. Some clients still ask for distance from some of TMZ's racier topics, says Eric Bader, senior vice-president for digital connections at MediaVest USA, which buys online ads. (Hershey asked for an ad to be dropped from a spot adjacent to coverage of Richards' tirade.) But any anxiety advertisers once had about such celebrity tabloids "has really burned off," Bader says. "The audience numbers are just too big."

—Ron Grover and Burt Helm

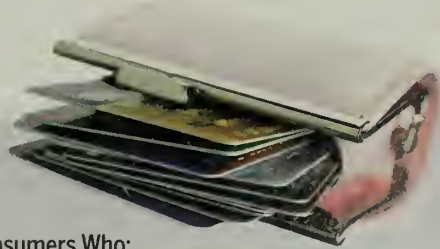
THE BIG PICTURE

WHERE CREDIT IS DUE

IT'S NO SECRET THAT Americans love their plastic. The average U.S. consumer has four credit cards, according to a recent nationwide sampling of 3 million consumer credit files. The most credit-happy states: New Hampshire and New Jersey, where 20% of consumers carry 10 cards or more. Meanwhile, 17% of credit-card users in Alaska and Hawaii exhaust at least half of their available credit limit. Here are some national averages. —Lindsey Gerdes

Percent of U.S. Consumers Who:

Have at least two credit cards	Have at least 10 credit cards	Use at least 50% of available credit
51	14	14



FILE-SHARING



BATTLING THE CAMPUS PIRATES

They're No. 1, but don't get out the big foam finger.

Athens-based Ohio University tops the Recording Industry Association of America's music piracy list, with the most copyright warnings received about students' illegal file-sharing: 1,287 so far this academic year. RIAA says such warnings are up dramatically, and on Feb. 28, CEO Mitch Bainwol announced the RIAA will replace warnings with pre-lawsuit notices for students.

Federal law requires the roughly 800 schools notified to stop repeat offenses or face liability. At No. 2 Purdue, with 1,068 notices, multiple violations lead to a warning and possible loss of Web access, but spokeswoman Jeanne Norberg says Purdue's wireless network can't easily match students with their IP addresses. Ohio U's interim CIO Shawn Ostermann says the school cuts Web access at offending addresses, sending students (ID'd when they report the problem) to a judicial board. Consequences are yet to be decided. —Paula Lehman

GENDER GAP

A TALE OF TWO INFLATIONS

ARE PRICES rising faster for women than for men? Recent research by David Rosenberg, chief North American economist for Merrill Lynch, identifies a male-female split in the inflation rate.

Crunching CPI data for the past year, Rosenberg found that goods and services geared toward women (including clothes and shoes, cosmetics, jewelry, housekeeping, and appliances) are posting bigger price rises than those catering to men (clothing, shoes, sporting goods, TVs, and auto parts and repairs).

While the gender gap isn't new, Rosenberg says the divergence has "widened considerably" in the past few months. Calculated separately, the "female inflation rate" is now 3.6% year over year, 18 times the 0.2% rate for men.

What's behind the disparity? In part, shifting demographics and job trends, which, in turn, affect demand—and thus prices.



Women currently enjoy greater employment growth than men, and their consumer confidence is at a six-year high. They are also marrying later or not at all. That matters, says Rosenberg, because single women spend a higher percentage of their income than single men do, and spend more on themselves, according to the latest Census Bureau's Consumer Expenditure Survey.

All this helps explain why prices for women's clothing and jewelry are growing at their fastest pace in over a decade while those for auto parts are holding steady and prices for big-screen TVs are declining. "If you're an investor with a stake in the U.S. consumer," Rosenberg says, "your portfolio should somehow reflect these demographic and economic forces."

—Elizabeth Woyke

STOCK ANSWERS

SEEKING WISDOM IN A CROWD

CONSIDERING A major strategic move, a CEO might go to a few trusted advisers for guidance or bring in an investment banker. David Cummings, the iconoclastic founder of **BATS Trading**, is asking about 1,500 of his closest friends.

Cummings, whose fast-growing Kansas City (Mo.) electronic market is nibbling into **NASDAQ'S** volume, wants to develop a European strategy. So in a Feb. 27 e-mail to Wall Street types—everyone from traders to NYSE and NASDAQ executives—he asked for advice: Should BATS, which stands for Better Alternative Trading System, tie up with existing markets? License technology? Start a



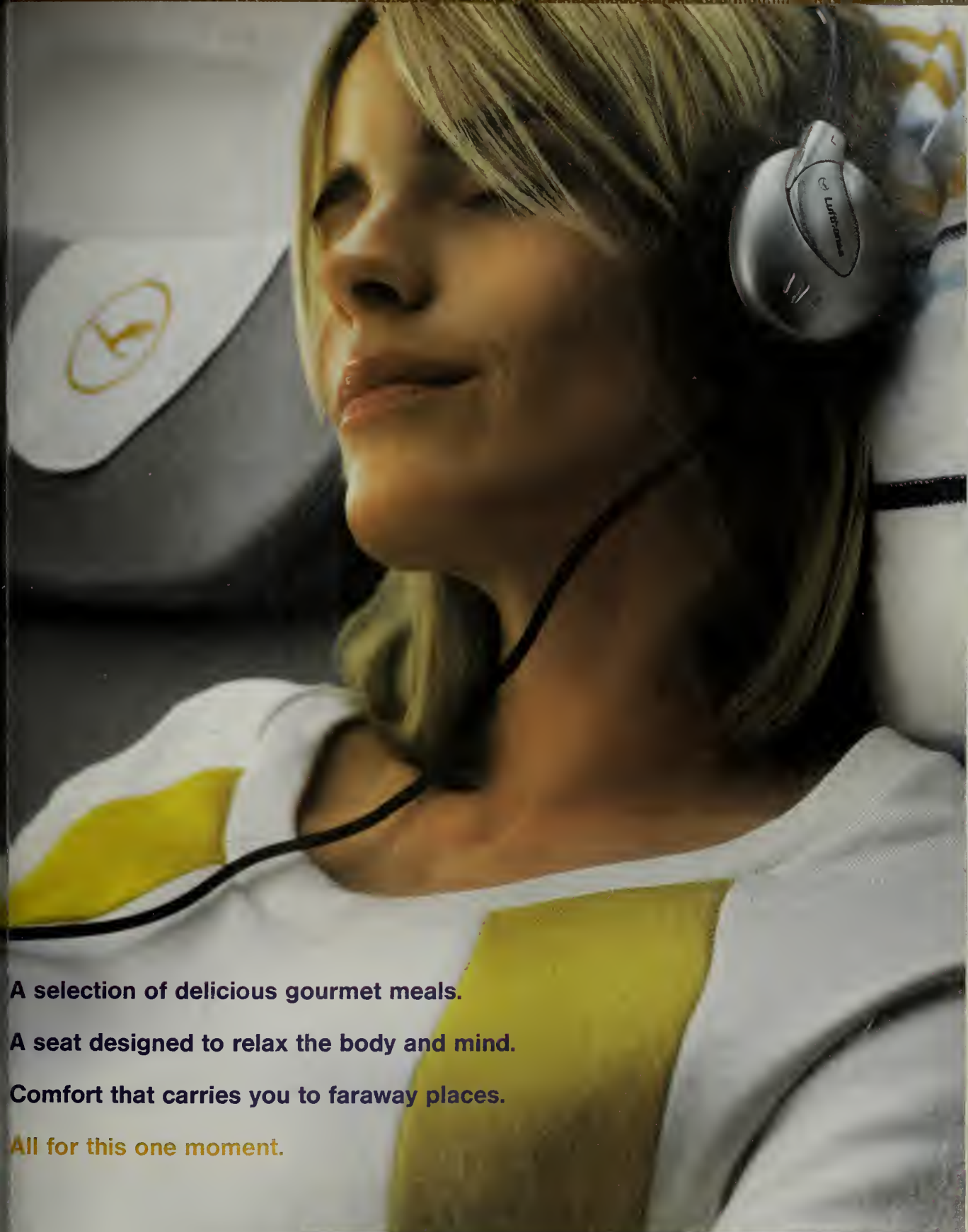
subsidiary? Set up a cross-ownership deal? Stay home?

Cummings frequently sends out "Dear Trading Community" e-mails in which he simply opines. Is he serious about soliciting ideas? Quite,

he says, adding: "If they are really good ideas, a job offer is possible."

The issue of going into Europe arose when he read erroneous British press reports that BATS was looking to buy into **Plus Markets Group**, a British electronic market that he "had hardly heard of." Then he looked at its Web site and realized the idea might not be a bad one, he wrote in the Feb. 27 e-mail, urging his readers to help him contact the company. Taking a jab at NASDAQ's failed hostile bid for the London Stock Exchange, Cummings added that he won't make an unwelcome run. What do the folks at Plus say? London-based executives would be "happy to put the kettle on and have a cup of tea with him," a spokesman says.

—Joseph W.



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A STAR ALLIANCE MEMBER

SILVER LININGS

A PRIME DEAL FOR BEAR STEARNS

HOW BAD is business for subprime lenders? As defaults mount from mortgage borrowers with shaky credit histories, some of these lenders are shuttering. Others are being bought by Wall Street firms.

First Franklin Financial was snapped up by **Merrill Lynch** for \$1.3 billion in December. Then there's the case of **Encore Credit Corp.**, an Irvine (Calif.) mortgage bank with a subprime specialty.

On Feb. 12, **Bear Stearns** closed a deal to buy Encore for \$26 million, an amount that turned out to be less

than what **Encore's** parent, **ECC Capital**, owed Bear Stearns for financing the subprime loans. To make up the difference, ECC gave \$7 million to Bear Stearns, the buyer, as the loans

ECC sold in the market fetched less than anticipated.

ECC Capital officials declined to comment, but the deal wasn't a total loss for

ECC staff, some of whom are migrating to Bear Stearns to head subprime-loan underwriting.

Thomas Marano, Bear Stearns' head of mortgage and asset-backed securities, says he values the ECC staffers' expertise while noting that the investment bank's "exposure to subprime is not particularly large."

—Matthew Goldstein



DIVERSIONS

E-TOONS IN MOTION

THE NEW YORKER's iconic cartoons as Web videos? They're now available as animations at Apple's iTunes Store, and they'll soon be on newyorker.com. The free videos run 15 to 20 seconds (including an ad) and add sound, movement, and color. Each takes six weeks to adapt, using independent artists and actors, say Jim Cox and Michael Fry, who head RingTales, the Santa Monica (Calif.) new-media outfit that licensed the right to animate and distribute the 70,000-plus cartoons. Besides Web sites, RingTales sees a market in mobile phone and e-mail "cartoon of the day" subscriptions. It soon expects to add animations of three "household name" comic strips.

—Elizabeth Woyke

BLOGSPOTTING JOB LORE

www.cheezhead.com

» **SEARCHING FOR** job openings—or candidates—on the Web can feel like casting a net into an abyss. This blog about online recruiting, written by Joel Cheesman, has an industry-insider feel at times. But it'll help you understand the cyber-job world and the search engines that pair candidates with recruiters. Cheesman, who advises employers on their Web-based talent hunts, has the scoop on everything from coding tricks that can put an unknown site on Google's radar to the latest on the upcoming partnership between Jobster and Facebook.

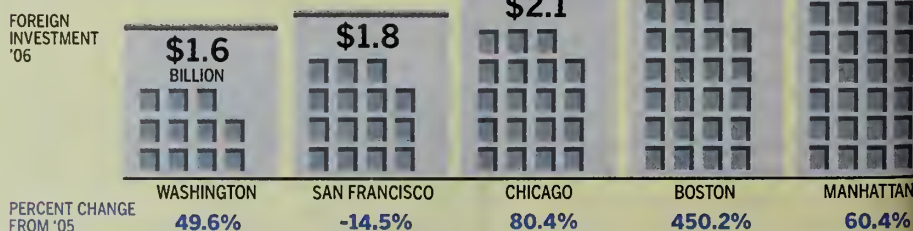
—Lindsey Gerdes

FOREIGN INVASION

An Office Party

THEY'LL TAKE MANHATTAN—for starters. Foreigners spent a record \$37.7 billion on U.S. commercial property in 2006, says a report by real estate firm Jones Lang LaSalle. All major metro markets except San Francisco and L.A. had gains in foreign investment. Why the Left Coast snub? Asian investors are buying closer to home, and California is too long a plane ride for Europeans, says JLL. —Michael Arndt

TOP 5 U.S. MARKETS FOR FOREIGN INVESTMENT





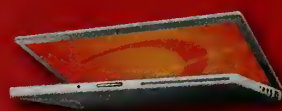
new technology can optimize your office performance.
And your outlook in the office, too.



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• Memory: 512MB
• CD-RW/DVD-ROM combo drive
• Built-in AirPort® Extreme and Bluetooth®
• Built-in iSight™ camera
• Front Row and Apple® Remote included
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\$899



\$670 INSTANT SAVINGS²

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• Memory: 512MB
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• Built-in AirPort Extreme® and Bluetooth®
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• 15.4" WXGA+ display



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ANALYZE THIS

BY KERRY SULKOWICZ, M.D.

Your Procrastinatin' Heart

I procrastinate, and always have. When I had a corporate job, I would put off work that was challenging, then cram to make the deadline as my stress level soared. Now I own a small business, and the pattern remains. If I'm to give a presentation to potential clients, for instance, I prepare only at the last minute, my anxiety mounting as the day approaches and I do nothing. How can I change?

M.L., New York

FINISHING THIS column with only moments to spare, I—and presumably many readers—can relate to your problem. While almost everyone puts things off occasionally, as an expression of annoyance or ambivalence about a task, chronic procrastinating can be a symptom of a psychological problem.

Since procrastination is rarely rational (Why would anyone want to experience the anxiety you report?), it's important to uncover the hidden motivations and meanings that allow it to have such an iron grip. For some people, it is a kind of behavioral retention—action being withheld to the point of extreme discomfort. For others, it represents a way to provoke an

authority figure (real or imagined) from whom disappointment or punishment is expected if there's a failure to deliver. Procrastination can even be a way of flirting with self-destructiveness: People can receive an addictive thrill from completing tasks just under the wire, as if they've just gotten away with something.

In your case, especially now that you're the boss, preparing presentations at the last minute ensures that you never feel relaxed and may even signal an underlying conflict about being successful or feeling like a real adult. If you feel guilty about success or fearful of the hard-earned freedom that comes from running your own company, then procrastination is a sure way to clip your wings.

The first step to making a change: Ask yourself what you might be getting out of this high-risk behavior. As an experiment, just once muster the will necessary to



prepare earlier. As you're working, pay attention to any anxieties that emerge. Does acting like an adult in this way engender feelings of abandonment or isolation? Is preparing something thoroughly scary for you because it might produce a high level of quality you'd have to match again and again?

Whatever emotions come up will provide

clues as to why your instincts all point toward delay. This kind of introspection about hidden motivations is hard to do on your own, but it can unlock more adaptive behavior. If the attempt at self-help fails and you're a chronic procrastinator in other contexts, too, it might be worth exploring the issue with a therapist.

Kerry J. Sulkowicz, M.D., a psychoanalyst and founder of the Boswell Group, advises executives on psychological aspects of business. Send questions at analyzethis@businessweek.com

QUESTION OF THE WEEK

If you could carve one mean, lean auto machine out of The Big Three, what five U.S. car brands would that imaginary company sell to compete with Toyota?

"Ford's Europe division has compelling designs. Chevy still has the world's most recognizable brand and great trucks. Jeep is the genuine article. Cadillac's upward trajectory is its own to squander. Aston Martin is a Cinderella story."

Michael Spinelli, editor, *Jalopnik.com*

"I'd take Jeep because it's an icon, Cadillac because it's successful, and Chevy and Ford for the sales volume and truck business. I'd also stick to my allegiance and keep the Chrysler brand."

Thomas Stallkamp, former Chrysler president; partner, Ripplewood Partners

"Cadillac, for luxury. Chevrolet and Ford as standard bearers in cars, trucks, and new technologies. Chrysler, reenergize and continue to dominate the minivan market. Jeep, to take on SUVs."

David Davidson, editor-in-chief, *WindingRoad.com*; founder, *Automobile magazine*



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It's what you've been craving. Peaceful sleep without a struggle. That's what LUNESTA® is all about: helping most people fall asleep quickly, and stay asleep all through the night. It's not only a narcotic, it's approved for long-term use. So you can feel comfortable taking it night after night. Talk to your doctor first before using sleep aids for extended periods. Tonight, just close your eyes, and *leave the rest to Lunesta.*

Find out how to improve your sleep habits at www.lunesta.com. Or call 1-800-Lunesta.

Lunesta
(eszopiclone)
1.2 AND 3 MG TABLETS

IMPORTANT SAFETY INFORMATION: LUNESTA works quickly, and should be taken right before bed. Be sure you have at least 7 hours to devote to sleep before becoming active. Until you know how you'll react to prescription LUNESTA, you should not drive or operate machinery. Do not use alcohol while taking LUNESTA. Most sleep medicines carry some risk of dependency. Side effects may include unpleasant taste, headache, drowsiness and dizziness. See important patient information on the next page.

LunestaTM

(eszopiclone)c
1, 2 AND 3 MG TABLETS

Please read this summary of information about LUNESTA before you talk to your doctor or start using LUNESTA. It is not meant to take the place of your doctor's instructions. If you have any questions about LUNESTA tablets, be sure to ask your doctor or pharmacist.

LUNESTA is used to treat different types of sleep problems, such as difficulty in falling asleep, difficulty in maintaining sleep during the night, and waking up too early in the morning. Most people with insomnia have more than one of these problems. You should take LUNESTA immediately before going to bed because of the risk of falling.

LUNESTA belongs to a group of medicines known as "hypnotics" or, simply, sleep medicines. There are many different sleep medicines available to help people sleep better. Insomnia is often transient and intermittent. It usually requires treatment for only a short time, usually 7 to 10 days up to 2 weeks. If your insomnia does not improve after 7 to 10 days of treatment, see your doctor, because it may be a sign of an underlying condition. Some people have chronic sleep problems that may require more prolonged use of sleep medicine. However, you should not use these medicines for long periods without talking with your doctor about the risks and benefits of prolonged use.

Side Effects

All medicines have side effects. The most common side effects of sleep medicines are:

- Drowsiness
- Dizziness
- Lightheadedness
- Difficulty with coordination

Sleep medicines can make you sleepy during the day. How drowsy you feel depends upon how your body reacts to the medicine, which sleep medicine you are taking, and how large a dose your doctor has prescribed. Daytime drowsiness is best avoided by taking the lowest dose possible that will still help you sleep at night. Your doctor will work with you to find the dose of LUNESTA that is best for you. Some people taking LUNESTA have reported next-day sleepiness.

To manage these side effects while you are taking this medicine:

- When you first start taking LUNESTA or any other sleep medicine, until you know whether the medicine will still have some effect on you the next day, use extreme care while doing anything that requires complete alertness, such as driving a car, operating machinery, or piloting an aircraft.
- Do not drink alcohol when you are taking LUNESTA or any sleep medicine. Alcohol can increase the side effects of LUNESTA or any other sleep medicine.
- Do not take any other medicines without asking your doctor first. This includes medicines you can buy without a prescription. Some medicines can cause drowsiness and are best avoided while taking LUNESTA.
- Always take the exact dose of LUNESTA prescribed by your doctor. Never change your dose without talking to your doctor first.

Special Concerns

There are some special problems that may occur while taking sleep medicines.

Memory Problems

Sleep medicines may cause a special type of memory loss or "amnesia." When this occurs, a person may not remember what has happened for several hours after taking the medicine. This is usually not a problem since most people fall asleep after taking the medicine. Memory loss can be a problem, however, when sleep medicines are taken while traveling, such as during an airplane flight and the person wakes up before the effect of the medicine is gone. This has been called "traveler's amnesia." Memory problems have been reported rarely by patients taking LUNESTA in clinical studies. In most cases, memory problems can be avoided if

you take LUNESTA only when you are able to get a full night of sleep before you need to be active again. Be sure to talk to your doctor if you think you are having memory problems.

Tolerance

When sleep medicines are used every night for more than a few weeks, they may lose their effectiveness in helping you sleep. This is known as "tolerance." Development of tolerance to LUNESTA was not observed in a clinical study of 6 months' duration. Insomnia is often transient and intermittent, and prolonged use of sleep medicines is generally not necessary. Some people, though, have chronic sleep problems that may require more prolonged use of sleep medicine. If your sleep problems continue, consult your doctor, who will determine whether other measures are needed to overcome your sleep problems.

Dependence

Sleep medicines can cause dependence in some people, especially when these medicines are used regularly for longer than a few weeks or at high doses. Dependence is the need to continue taking a medicine because stopping it is unpleasant.

When people develop dependence, stopping the medicine suddenly may cause unpleasant symptoms (see *Withdrawal* below). They may find they have to keep taking the medicine either at the prescribed dose or at increasing doses just to avoid withdrawal symptoms.

All people taking sleep medicines have some risk of becoming dependent on the medicine. However, people who have been dependent on alcohol or other drugs in the past may have a higher chance of becoming addicted to sleep medicines. This possibility must be considered before using these medicines for more than a few weeks. If you have been addicted to alcohol or drugs in the past, it is important to tell your doctor before starting LUNESTA or any sleep medicine.

Withdrawal

Withdrawal symptoms may occur when sleep medicines are stopped suddenly after being used daily for a long time. In some cases, these symptoms can occur even if the medicine has been used for only a week or two. In mild cases, withdrawal symptoms may include unpleasant feelings. In more severe cases, abdominal and muscle cramps, vomiting, sweating, shakiness, and, rarely, seizures may occur. These more severe withdrawal symptoms are very uncommon. Although withdrawal symptoms have not been observed in the relatively limited controlled trials experience with LUNESTA, there is, nevertheless, the risk of such events in association with the use of any sleep medicine.

Another problem that may occur when sleep medicines are stopped is known as "rebound insomnia." This means that a person may have more trouble sleeping the first few nights after the medicine is stopped than before starting the medicine. If you should experience rebound insomnia, do not get discouraged. This problem usually goes away on its own after 1 or 2 nights.

If you have been taking LUNESTA or any other sleep medicine for more than 1 or 2 weeks, do not stop taking it on your own. Always follow your doctor's directions.

Changes In Behavior And Thinking

Some people using sleep medicines have experienced unusual changes in their thinking and/or behavior. These effects are not common. However, they have included:

- More outgoing or aggressive behavior than normal
- Confusion
- Strange behavior
- Agitation
- Hallucinations
- Worsening of depression
- Suicidal thoughts

How often these effects occur depends on several factors, such as a person's general health, the use of other medicines, and which sleep medicine is being used. Clinical experience with LUNESTA suggests that it is rarely associated with these behavior changes.

It is also important to realize it is rarely clear whether these behavior changes are caused by the medicine, are caused by an illness, or have occurred on their own. In fact, sleep problems that do not improve may be due to illnesses that were present before the medicine was used. If you or your family notice

any changes in your behavior, or if you have any unusual or disturbing thoughts, call your doctor immediately.

Pregnancy And Breastfeeding

Sleep medicines may cause sedation or other problems in the unborn baby when used during the last part of pregnancy. Be sure to tell your doctor if you are pregnant or planning to become pregnant, or if you are breastfeeding while taking LUNESTA.

In addition, a very small amount of LUNESTA may be present in breast milk after use of the medication. The effects of small amounts of LUNESTA on an infant are not known, therefore, as with all other prescription sleep medicines, it is recommended that you not take LUNESTA if you are breastfeeding a baby.

Safe Use Of Sleep Medicines

To ensure the safe and effective use of LUNESTA or any other sleep medicine, you should observe the following cautions:

1. LUNESTA is a prescription medicine and should be used ONLY as directed by your doctor. Follow your doctor's instructions about how to take, when to take, and how long to take LUNESTA.
2. Never use LUNESTA or any other sleep medicine longer than directed by your doctor.
3. If you notice any unusual and/or disturbing thoughts or behavior during treatment with LUNESTA or other sleep medicine, contact your doctor.
4. Tell your doctor about any medicines you are taking, including medicines you may buy without a prescription and herbal preparations. You should tell your doctor if you drink alcohol. DO NOT use alcohol while taking LUNESTA or any other sleep medicine.
5. Do not take LUNESTA unless you are able to get at least 7-8 hours of sleep before you must be active.
6. Do not increase the prescribed dose of LUNESTA or any other sleep medicine unless instructed by your doctor.
7. When you first start taking LUNESTA or any other sleep medicine, until you know whether the medicine will still have some effect on you the next day, use extreme care while doing anything that requires complete alertness, such as driving a car, operating machinery, or piloting an aircraft.
8. Be aware that you may have more trouble sleeping the first night or two after stopping any sleep medicine.
9. Be sure to tell your doctor if you are pregnant or planning to become pregnant, if you are breastfeeding a baby, or if you are taking LUNESTA.
10. As with all prescription medicines, never use LUNESTA or any other sleep medicine with alcohol. Always store LUNESTA or any other sleep medicine in the original container and out of reach of children.
11. Be sure to tell your doctor if you suffer from depression.
12. LUNESTA works very quickly. You should take LUNESTA immediately before going to bed.
13. For LUNESTA to work best, you should not take it immediately after a high-fat, heavy meal.
14. Some people, such as older adults (i.e., age 65 and over) and people with liver disease, should use the lower dose (1 mg) of LUNESTA. Your doctor will choose to start therapy at 2 mg. In general, people under age 65 should be treated with 2 or 3 mg.
15. Each tablet is a single dose; do not crush or chew the tablet.

Note: This summary provides important information about LUNESTA. If you would like more information, ask your doctor or pharmacist to let you read the Patient Information and then discuss it with him or her.

Rx only



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“The bogeyman I am now chasing is the structure of American corporations.”

—Carl Icahn
New York

People | Prince of Prizes

Just Don't Call Him a Raider

Carl Icahn, who now styles himself a shareholder activist, prepares for battle

By David S. Shields

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Carl Icahn, who now styles himself a shareholder activist, prepares for battle

ICAHN: ON ACTIVIST INVESTORS AND PRIVATE EQUITY RUN WILD

I FOUND THE article “Just don’t call him a raider” (People, Mar. 5) somewhat humorous. In it, writer Ronald Grover discusses in detail the large sums of money I have made as an activist investor. However, while his facts are accurate, he completely misses the essence of my argument concerning the need for activists. Early on, Grover states that I told him that private equity investors go after companies and their mounds of cash, rip them apart, and enjoy the spoils. “How different is that from Icahn?” Grover wonders. His answer: “Not much.”

I vehemently disagree. The difference is enormous. Today’s activist, by campaigning against management, greatly enhances the value of a company for the benefit of all shareholders, while private equity firms keep most of the spoils for themselves when they purchase a company. On Feb. 26, almost on cue, Temple-Inland Inc. (a company I recently announced I would challenge in a proxy fight) announced it was splitting into four parts. The stock immediately jumped seven points. Since I announced my intention to mount a proxy fight with Temple-Inland on Jan. 22, the stock has

increased 34%, creating \$1.6 billion in value for all shareholders. When I congratulated Temple-Inland CEO Kenneth M. Jastrow II, we both agreed that if the company had entered into a transaction with private equity rather than doing the restructuring, most of this increased value would have gone to third parties rather than the shareholders. At times, there is a need for private equity, but today it has gotten completely out of hand.

What is troubling about the *BusinessWeek* article and other articles about activist investing is that journalists overlook or even deny how much activist investing helps the average investor (referred to by Grover as the “common man”). For example, the article states that my fund made \$370 million on Kerr-McGee but fails to note that as a result of my activism, the share price of KMG increased from 30.06 to 70.50 and that total shareholder value increased by almost 135%, or \$10 billion. In the case of Time Warner, the article accurately points out that I made approximately \$250 million but again fails to note that shareholder value increased by almost \$15 billion since I first invested in the company.

A study of all of my public investments

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BusinessWeek
 MARCH 12, 2007 (ISSN 0007-7135) *** 4025

Published weekly, except for one week in January, July and August by The McGraw-Hill Companies, Inc. **FOUNDER:** James H. McGraw (1860-1948).

EXECUTIVE, EDITORIAL, CIRCULATION, AND ADVERTISING OFFICES: The McGraw-Hill Companies Building, 1221 Avenue of the Americas, New York, N.Y. 10020. Telephone: 212-512-2000. Telex: Domestic 127039; Intl. 2360127039. For single copy sales call 1-800-298-9867 or email: busweek@nrmisinc.com. Subscriber Services: 1-800-635-1200. TOLL: 1-800-554-1579

POSTMASTER: Send address changes to BusinessWeek, P.O. Box 8418, Red Oak, IA 51591-1418. Periodicals postage paid at New York, N.Y., and at additional mailing offices. Canada Post Publication Mail Agreement Number 40012501.

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ReadersReport

since November, 2004, shows an increase in total shareholder value in excess of \$55 billion. If prodding boards and CEOs can attain such results, what does this tell us about the level of management in our country and how much value is being wasted? Grover states that I have been chasing "bogeymen for much of my life." I agree, but he goes on to state that the bogeyman I am now chasing is "private equity." That is inaccurate. The bogeyman I am now chasing is the structure of American corporations, which permit managements and boards to rule arbitrarily and too often receive egregious compensation even after doing a subpar job. Yet they remain accountable to no one.

If corporate democracy is not restored so that managements and boards can be removed when they prove to be inadequate, we will lose our ability to compete in global markets. This will prove disastrous for the value of the dollar, our credit markets, and our economy. Unfortunately, activism is the only means we now have to hold our boards and CEOs accountable because, sadly, corporate democracy is nonexistent.

—Carl Icahn
New York

CORRECTIONS & CLARIFICATIONS

"The 21st century meeting" (Future of Tech, Feb. 26) mischaracterized PictureTel's relationship with IBM in 1991. PictureTel was not a subsidiary of IBM but had a joint marketing agreement with IBM to develop a desktop video system.

"The real scandal at Citi" (News & Insights, Feb. 26) incorrectly identified Jay S. Fishman as a former Citigroup board member, rather than as a former Citigroup executive.

OF SMALL-BUSINESS TAXES, PORK, AND THE MINIMUM WAGE

PORK, AS MAX B. SAWICKY [Economic Policy Institute economist] himself points out in "Minimum wage, maximum pork" (Outside Shot, Feb. 19), involves taxpayers' money going to specific representatives' districts for projects such as Ohio's National Packard Museum, Alabama's statue of Vulcan, and Alaska's bridge to nowhere. Tax breaks, unless they are targeted to large defense contractors that operate out of Pennsylvania, are not pork.

Sawicky equates letting people keep

their money with giving them more. But letting people keep their money is not the same as giving tax revenue to contractors that line senators' pockets. Also, the tax cuts in question will benefit people in all 50 states. To me, this qualifies these tax cuts as pork.

—Wendell C. Lee
Newark, N.J.

SAWICKY MAKES a good point in serving that tax relief for small business, which is holding up passage of the federal minimum wage increase, is a bad policy. It confers benefits on businesses that may not employ any minimum wage workers. The same solution, however, can be made again: let the minimum wage increase itself. Most of the people it would help are not in poverty. I would argue that the damage done by the small-business tax break is nothing compared with the damage done in the labor market by having politicians dictate wage increases. A minuscule loss in taxes just means politicians have somewhat fewer dollars to squander, while the market increase in labor costs will throw people out of work and make it



ler for low-skilled laborers to find at all.

—George C. Leef
Raleigh, N.C.

TIME TO REDUCE CO₂ EMISSIONS, NO MATTER WHAT

CONSIDER YOUR "Question of the Week" (Up Front, Feb. 19), asking skeptics of global warming their opinion of the J.N. report, completely disingenuous. The responses ignored the real impact of the report.

The scientific consensus on the human impact on global warming is totally wrong. We spend billions of dollars reducing carbon dioxide emissions needlessly, the effort will probably be a modest slowdown in economic growth. If we do nothing about CO₂ emissions and the scientific consensus is correct, the result will be global catastrophe. Choosing the former over the latter isn't a hard choice to make. We do it every day in business. We call it insurance.

—James A. Wirth
Pittsburgh

MAINLY IF WE only look at recent trends like warm summers, severe droughts, and melting glaciers, we could

be looking at normal variability that was not caused by human actions. But the question we should ask ourselves is why the current concentration of atmospheric carbon dioxide is more than 20% higher than it ever was in the 600,000 years prior to the Industrial Age. Those data were contained in the U.N. report on global warming. Is that not a strong indicator of human causation?

—Richard Wanat
Southfield, Mich.

NEWSPAPERS ARE ALIVE AND KICKING

IT WAS CERTAINLY refreshing to read "Hot news in Nowheresville" (Media, Feb. 19). Lately, I have taken to checking my pulse after every "declining circulation and revenue" big-city newspaper story or MediaCentric column.

Yes, newspapers are evolving, and yes, the newspapers most in jeopardy are those that depend on big-money advertisers. But there are other stories, too. Eleven years ago my friends and I began a free hometown weekly, and distribution has increased from zero to 52,500 papers about 60 pages deep. We're successful, but we've never had

the pleasure of meeting a 20% profit margin. We shake customers' hands more and wring our hands less. And there are hundreds, if not thousands, of us across the U.S.

For us, there is change in the wind, and tomorrow's newspapers will embrace it today. Please don't bury newspapers yet.

—Thomas V. Ward, Publisher
The Valley Breeze
Cumberland, R.I.

How to reach BusinessWeek

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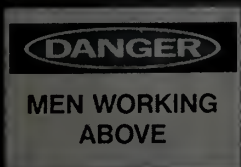
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Tech&You

BY STEPHEN H. WILDSTROM

Goodbye to Office? Not Yet

The notion that cheap or free Web-based word processing or spreadsheet programs could replace traditional software like Microsoft Office is becoming more realistic all the time. Outfits like Google, ThinkFree, and Zoho have new and better services every day. And now startup Transmision has come out with Glide OS 2.0, a package that aims to replace nearly all

the software on your computer.

At the moment, Glide's ambitions exceed its ability to deliver by a fair margin. It's still officially only in beta (a state Google's Gmail has been in for three years) and is clearly a work in progress. But as a demonstration of where Web-based software may be headed, Glide (www.glidedigital.com) is a fascinating experiment.

The suite covers most things consumers do on their computers. There's a word processor, a photo editor, a drawing program, a presentation program, and a blog-writing tool along with e-mail, calendar, contact list, chat, and file-sharing. And, of course, you can play music and videos, read news feeds from Web sites, and check the weather.

All of this is done within a Web browser, and the data are stored on Glide's servers, not your hard drive. Pricing is based on storage: A free basic account offers 300 megabytes of storage, not a lot if you're going to do much with photos or other media. Paid accounts start at \$4.95 a month or \$49.95 a year for 2 gigabytes of storage. Once your information is in the Glide system, you can get to it from anywhere. The applications are based on Adobe's Flash 9 software, meaning they will work on any system that can run Flash. A mobile version formats Glide for the small screens of handheld devices.

I TRIED GLIDE ON A VARIETY OF SYSTEMS, large and small: Windows XP and Vista PCs and a Mac, with 24-inch displays; laptops, a Samsung Q1 ultramobile PC with a 7-inch screen, Palm Treos, even a BlackBerry. The experience varied dramatically. In all cases, though, I had access to my data and could use at least some of the applications with any of the devices, wherever I happened to be.

Glide's main shortcoming is that it tries to do too many things and doesn't do many of them particularly well yet. The home screen is a jumble, often providing a couple of ways to do something when one is all you need. And the quality of the applications varies greatly. The word processor is straightforward and reasonably full-featured. It normally stores



documents in Web-page (HTML) format, but also can save the Word or PDF files. Yet I couldn't find a way to open an existing document from within the word processing program; I had to go to the document list, select the one I wanted, and click "edit." The photo editor is both remarkably full-featured and fast. But I found the media player hopelessly confusing. And so it goes.

One major drawback of a Web-based software suite is that it works only when you are connected to the Internet. To get reasonable performance with Glide on a PC, you need a relatively fast broadband connection. That's no problem for many home users, but not for lots of business users who need to work on airplanes at hotels with slow connections.

All of the many companies working on Web-based applications are struggling with this issue. Glide provides a separate program, called G

Glide offers a peek at where Web-based tools may be headed

Sync, for exchanging data between online storage and a hard drive. And Adobe is working on a project, called Apollo, that will let Flash-based applications work without a Web connection.

So Glide has a ways to go before I would be willing to ditch Microsoft Office, Adobe Photoshop, or even Gmail. But that becomes a serious option may not be all that far off.

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Old Media's New Math

If you wanted, you could create the laboratory conditions for a spate of risky media deals. You'd want a market flooded with money from private equity, hedge funds, and bankers eager to lend at ever-increasing multiples of cash flow. You'd want a bunch of operating guys (and they remain almost exclusively guys) grumpy about life in previously conceived

media conglomerates and starry-eyed at the prospect of equity stakes that could turn into eight-figure fortunes. And you'd want a media world in flux, in which profits from once-steady sectors and properties cannot be presumed to be stable.

Actually, you don't have to construct it. You're soaking in it.

"IT'S BEEN PRETTY AMAZING that investment bankers haven't made more stupid deals," says one active player in this market. The math for media deals—we're talking about traditional media deals, since those for Web properties like MySpace and YouTube defy any standard metrics—is based on the cash-flow indicator EBITDA; that is, earnings before interest, taxes, depreciation, and amortization. Earlier this decade, say executives involved in the deal markets, those seeking to buy a media property could borrow about five times an acquisition's EBITDA. Today, they can borrow seven times. It's no surprise that lenders like this can jack up the price of a potential deal.

Meanwhile, more money keeps targeting this market. On Feb. 21 media-focused Providence Equity Partners announced it had raised \$12 billion for another buyout fund—its sixth. None of this automatically spells doom for media transactions, and no deal vehicles are being driven off the cliff just yet. But it is safe to say that the potential for dumbness is mushrooming. "We've seen this, and it doesn't work out well," offers one deal-side executive. At current maximum debt-to-EBITDA ratios, operating a company "doesn't leave a lot of room for error.... If you start running into problems—and you will, and there will be a recession—you won't be able to service the debt."

What sparked Wall Street's romance with media decades ago was the realization of just how much cash the companies of yore threw off. Some investors feel "media, as a consumer product, has some stability to it. And most media companies don't have a lot of capital spending needs," explains



Why bloated deals could sink under their own weight

million, and, after much tumult, widely believed to be worth a fraction of that—seems preordained. But I would never have guessed that magazines aimed at new parents would be hit hard by message board-y sites like Johnson's BabyCenter.com, even though that's exactly what has happened. (Two executives familiar with Time Inc.'s Parenting Group properties, which were just sold to Swire Bonnier Magazine Group, says their EBITDA was roughly halved from 2005 to 2006. A Time Inc. spokeswoman declined to comment.) The risks keep mounting. But the money keeps flowing. ■

CreditSights senior analyst Jake Newman: "They can generate pretty good cash flow as long as their business model is sound." This, coupled with the ease of borrowing, has led to a rise in highly leveraged deal proposals for Clear Channel and Univision. *BusinessWeek*'s corporate sibling Standard & Poor's noted in a report downgrading Univision's credit outlook that the potential deal would leave the company's total debt at 12 times its 2006 EBITDA.

Neither deal is necessarily heading for a crack-up. But ponder this portion of Newman's comment: "as long as their business model is sound." This is an era

in which long-held media revenue calculations have to be refigured practically weekly. It's not that the Web will destroy all traditional media businesses. It's that you can't pinpoint which sector will next face dismemberment by fast-blossoming newcomers.

In retrospect, the spectacular implosion of tech player Ziff Davis—bought by Willis Tower & Partners in 2000 for \$780

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JAMES C. COOPER

Inventory Swings Are Whipsawing the Economy

an adjustment in stockpiles has the potential to generate a rebound

U.S. ECONOMY

There's a new dynamic at work in the outlook. The ebb and flow of business inventories, and it has the potential to generate some ups and downs this year that could greatly affect perceptions of the economy's strength. The downside of the inventory cycle is happening right now, and it's at least partly to blame for the

sell-off in the U.S. stock market on Feb. 27. The initial spark was the plunge in Chinese equities, and worries about the U.S. economy fanned the fires. Some of those concerns reflected several weak economic reports of late, almost all of which have come from the industrial sector, which has been hit hard by the efforts of businesses to bring inventories into better alignment with sales. Comments by former Federal Reserve Chairman Alan Greenspan that a U.S. recession, while unlikely in 2007, was "possible," only added fuel. Few if any economists anticipated the extent of the inventory adjustment that was already well under way at the end of last year. Production cutbacks have been much greater than expected. Those cuts have weakened the industrial sector considerably, and they resulted in a downward revision on Feb. 28 to the government's estimate of fourth-quarter economic growth.

The Bureau of Economic Analysis now pegs last quarter's growth in real gross domestic product at only 0.7%, well below the 3.5% advance originally reported. Business inventories, which had grown by \$55 billion in the third quarter, after adjusting for inflation, rose only \$1 billion in the fourth (chart). That slowdown caused a contraction from GDP growth of 1.4 percentage points, instead of only 0.7, as the BEA first estimated. January reports on new factory orders and industrial surveys suggest the inventory realignment will be a further drag on growth in the first quarter.

STYLING INVENTORIES into better shape has had the biggest and most visible impact on manufacturing. However, it's important to keep in mind that the industrial sector accounts for less than a quarter of all products produced in the U.S. Real GDP in the much larger service sector, which employs about 80% of all full-time workers, grew a healthy 3.8% last quarter. The required adjustment in stockpiles is neither massive nor broad. The trimming appears concentrated in autos, construction supplies, and retail outlets that rely on building supplies and home goods. That's a change from the recent pattern in GDP growth outside the manufacturing and residential construction sectors. The economy

averaged only 2.1% growth in the second half of 2006, but excluding those two categories, which are only 8% of GDP, the second-half pace was 3.8%.

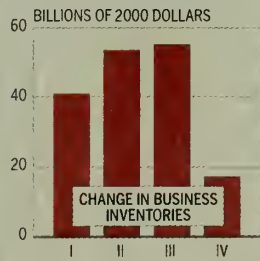
Compare what's happening now with the recession in 2001. Back then, inventories swung from an accumulation rate of about \$100 billion per quarter to a liquidation rate of almost \$90 billion. That \$190 billion swing over the period of a year and a half cut deeply into economic growth. The current downdraft is much tamer.

Still, the blow to manufacturing has been heavy. Manufacturing output has already declined at a 2.2% annual rate in the fourth quarter, the largest quarterly drop since the 2001 recession. Auto production fell 3.9%, after plunging 9.8% in the third quarter. Construction supplies declined 9.3%, and appliances and furniture dropped 8.8%. Those three sectors, which make up

20% of factory output, accounted for almost 45% of the overall fourth-quarter loss.

Plus, the weakness continued into the first quarter: Both January manufacturing output and new orders began the quarter below the fourth-quarter level. New orders taken by producers of durable goods dropped 7.8% in

A SHARP SLOWDOWN IN INVENTORY GROWTH



Data: Bureau of Economic Analysis, Global Insight Inc.

January. That report on Feb. 27 helped to fuel the stock sell-off, and it suggested factories may struggle through the first quarter. Although much of that fall reflected a huge 60% plunge in civilian aircraft, mainly at Boeing Co., orders outside the transportation sector also fell.

THERE'S A BRIGHT SIDE to the current inventory cycle, but there are risks. Further into 2007, the cycle's upside has the potential to generate a powerful rebound in the economy. As long as overall demand remains resilient, the necessary cutbacks will soon run their course, setting up a good chance for a sharp snapback in economic

growth this summer, as businesses gear up production again and begin to rebuild their inventories.

The biggest risk to the rebound scenario lies in the corporate sector. Business outlays for equipment fell unexpectedly in the fourth quarter, by 2.4%, and a big 6% drop in January capital-goods orders outside of defense and aircraft, the largest decline in three years, suggests more weakness. If businesses pull back on both capital spending and hiring, then the economy would lack the oomph it needs to restart a new upswing in production.

Housing is the other wild card. The market for new homes slumped further in January, with sales tumbling 16.6% from December to the lowest level in almost four years (chart). Weather differences in December and January may have played a big role in that result. Some good news: Sales of existing homes rose in January, suggesting that lower prices, low financing costs, and solid job markets are reducing the stock of unsold homes. One plus from the latest market turmoil is the drop in long-term interest rates, which will lower mortgage rates and add further support to housing demand.

DESPITE THE RISKS, resilient consumer spending is the best reason to believe the inventory correction will not be a heavy or extended drag on the overall economy. Demand is soft mainly in the housing and auto areas, and ongoing cutbacks in production and price discounting to move out excessive stockpiles have already whittled down the problem substantially.

The revised GDP numbers show overall demand rose 3.6% in the fourth quarter, much faster than the 2.2%

gain in GDP. The difference in those two increases reflects the sharp slowdown in inventory growth, suggesting a lot of those excess stockpiles were sold last quarter.

Consumer demand, in particular, appears to have remained strong in the first quarter. Based on the solid gain in January retail sales, even moderate

spending increases in February and March would yield another quarter of growth in real consumer spending in the neighborhood of 3.5%, close to the pace for all of 2006.

Moreover, consumers remain in good spirits. The Conference Board index of consumer confidence rose in February to the highest

JANUARY HOME SALES TAKE A TUMBLE



level in more than five years, buoyed by favorable assessments of job markets and income growth. Most notably, the proportion of households describing jobs "hard to get" fell to the lowest level since 2001.

For now, there's still no solid evidence of any broad severe weakness in the economy, and based on the Feb. 27 market plunge, stock investors appear overly bearish on U.S. economic prospects. If this inventory cycle follows the pattern of those in the past, there is a good chance the economy will look a lot stronger in the second half of the year than it does right now. ■

LABOR MARKETS

A Makeover for a Key Jobs Report

AN OVERHAULED version of Automatic Data Processing Inc.'s *National Employment Report* is due on Mar. 7. The changes should get monthly results a little closer to the Labor Dept.'s initial monthly payroll figure. But the report's more valuable contribution may be a better picture of the labor market in real time.

After being far off the mark a few times last year, the markets will be eager to see if the new *ADP National Employment Report* does a better job of foreshadowing the government's monthly measure of changes in private payrolls.

According to ADP and Macroeconomic Advisers, the report's creators, historical

data show that whenever the ADP estimate exceeds or undershoots the consensus expectation, the Labor Dept. number will do the same thing about 70% of the time. So the ADP data can be used to improve upon the consensus forecast. The changes also improve the accuracy of the monthly report relative to the government's results by about 17%.

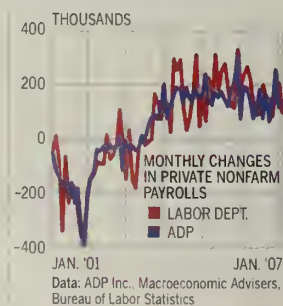
The ADP report now looks at nearly 400,000 businesses with payrolls totaling close to 23 million workers. That's larger than the initial pool used by the Labor Dept. Plus, the data are now being collected weekly, vs. monthly, and a more advanced seasonal adjustment is in place.

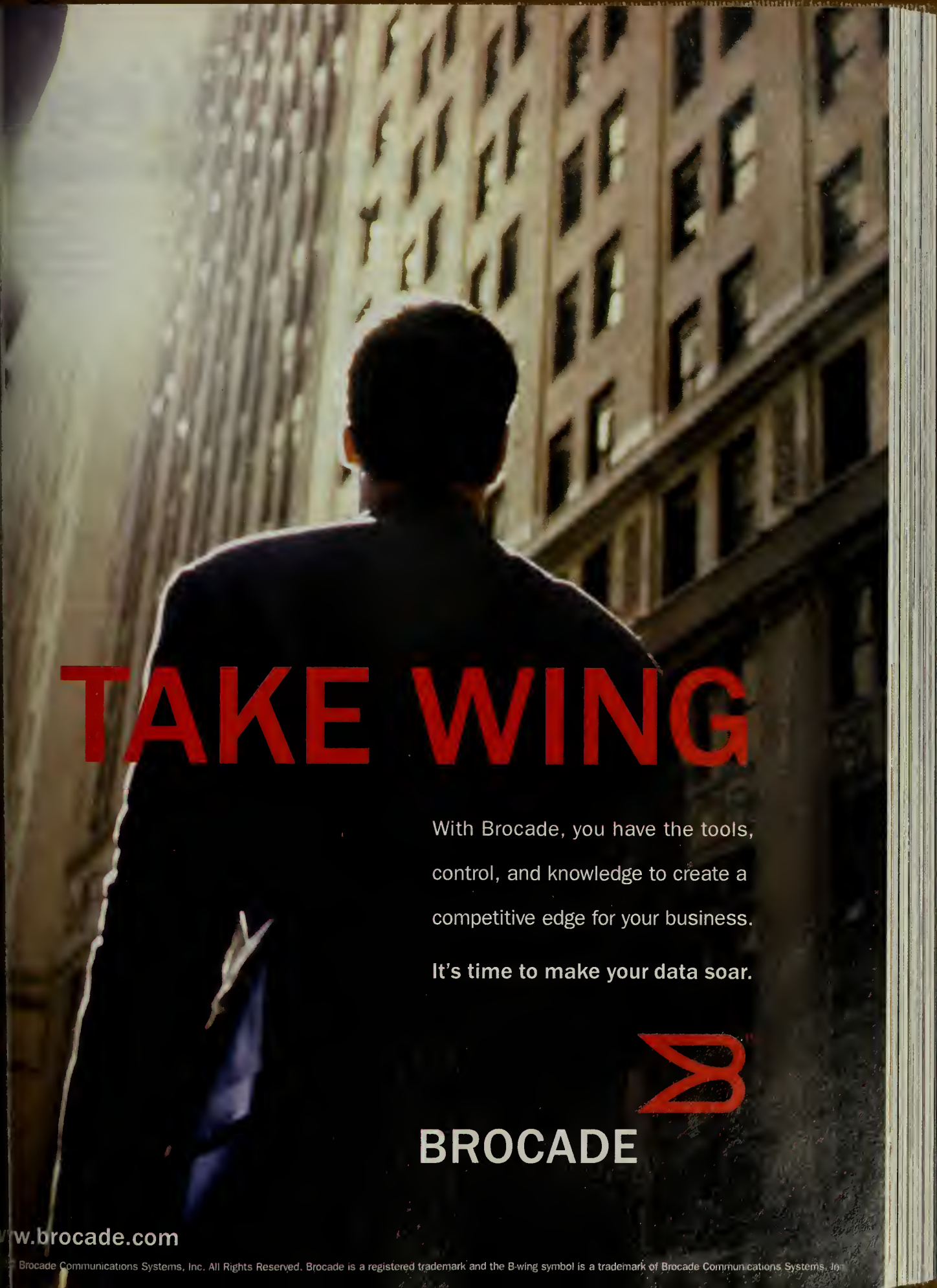
The two measures will still diverge from time to time. When that occurs, early evidence shows the ADP numbers come closer to the government's final annual employment revisions, released in early February, than the initial Labor Dept. jobs data. One reason is that the ADP report includes businesses not in the government's initial survey. That makes the report "particularly powerful if you are trying to understand what truly happened to employment, as it will eventually be reported by the [government]," says Macroeconomic Advisers Chairman Joel Prakken.

It will take time to convince the financial markets, but if the revised ADP report proves to be a reliable real-time estimate of true labor market conditions, it will end up being quite valuable. ■

—By James Mehring in New York

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NEWS YOU NEED TO KNOW EDITED BY HARRY MAURER



THE MARKETS TURN TAIL

Higher, higher, higher, then blam! For no obvious reason, Shanghai's pumped-up stock market fainted dead away on Feb. 27. Contagion then circled the globe, infecting bourses from France to Brazil to the U.S. After months in which markets rose at a stately pace, the sell-off reminded investors that stocks sometimes go down, too. Shanghai fell 8.8%, France and Germany 3%, and the Dow 3.3%, or 416 points (photo, the Big Board trading floor).

Fed Chairman Ben Bernanke testified on Feb. 28 that he couldn't see any single trigger for the panic, but that didn't stop the pundits. Some blamed a speech by his predecessor, **Alan Greenspan**, who said he couldn't rule out a 2007 recession in the U.S. Others fingered rumors of a new tax to discourage stock speculation in China. Or rising global interest rates, or U.S. subprime mortgage woes. Others pointed to a much-worse-than-expected durable goods production number. Some markets recovered a bit on Feb. 28, so the pain may be short-lived. But investors won't forget the shock for a while, and may have to get used to greater volatility. See "Prepare for turbulence," page 34

A Titanic Offer for TXU

How do you sell the biggest leveraged buyout in history? Give everyone a piece of the pie. Private equity giants **Kohlberg Kravis Roberts** and **Texas Pacific Group** on Feb. 26 proposed to buy Dallas utility TXU for an electrifying \$45 billion. TXU Chairman and CEO **C. John Wilder** will probably stick around. The company would drop plans to build 8 of the 11 new coal plants that had inflamed

greens. Utility customers will get something, too—a 10% cut in their bills through September, 2008. Still, regulators and lawmakers in Washington and Austin may balk, and other bidders could jump in. See "Hugging the tree huggers," page 66

WellPoint's New Boss

This one merits double superlatives: On Feb. 26, WellPoint

announced that **Angela Braly**, 45, will take over on June 1. That will make WellPoint, the nation's No. 1 health insurer, also the largest publicly held company to be run by a woman. Braly is general counsel of the \$60-billion-a-year **Blue Cross & Blue Shield** marketer. Outgoing CEO **Larry Glasscock**, who made acquisitions that built WellPoint into an insurer for 34.1 million Americans, plans to stay on as chairman.

Chasing Chrysler

There's little doubt **General Motors** is keen to snap up its hometown rival, **Chrysler Group**, from German parent **DaimlerChrysler**. *The Financial Times* reported on Feb. 26 that GM is eager for a deal and would consider giving the Germans an equity stake in return. Neither company will comment, but one GM source says the company would only take Chrysler for next to nothing. Canadian automaker **Magna International** also seems interested. A source close to the situation says Magna has looked at Chrysler's plan. Expect Chrysler to be sold to someone by late summer.

ONLINE "Which road for Chrysler?" www.businessweek.com/go/t

Citi's Money Guy

Citigroup CEO Charles Prince may go good on his promise to name a CFO within 45 days of replacing **Sallie Krawcheck**, who returned to her post as head of wealth management on Jan. 15 by hiring **American Express CEO Gary Crittenden**. Prince brings on a respected straight-shooter who will better navigate a volatile interest rate environment and manage the balance sheet. Crittenden, however, wasn't an instant hit: Citi stock fell 2% the day the news broke.

A Leak at UBS?

Businessweek.com reported Feb. 26 that federal prosecutors and securities watchdogs would soon file charges against a New York employee of Swiss bank UBS for allegedly selling advance notice of changes in analysts' ratings to traders. See "When hedge funds cross the line," page 46

Microsoft Says "Ouch"

In what could be the stiffest patent infringement judgment ever—if it holds—a federal jury in San Diego on Feb. 23 ordered Microsoft to pay \$

in to **Alcatel-Lucent** in a case involving **MP3** audio technology. The MP3 compression standard was created by Lucent's labs along with scientists at **Fraunhofer**, a German think tank. Microsoft had licensed the technology from Fraunhofer, but Alcatel-Lucent argued the case covered different intellectual property. Microsoft says it asked for a review. *An idea incubator tries to cash," page 61*

Blitz's Mea Culpa
Did Valentine's Day note **Starbucks** Chairman **Howard Schultz** sent shares down on Feb. 26 after it was disclosed and posted on the **ucksgossip.com** blog. In a memo, Schultz laments moves to streamline the company led to "what some might call the commoditization of our brand." Among the items: automatic espresso machines and vacuum-sealed coffee packs, two innovations that boost efficiency but have the pleasant sights and smells customers used to get with their \$4 latte.

Plant Grows in Tupelo
Citing more evidence that Toyota is trying to win over the red state, **Toyota** said on Feb. 27 it will build a new SUV plant near **Tupelo, Miss.**, hiring 1,000 and investing \$1.3 bil-

lion to make 150,000 vehicles a year. Toyota, which just opened a plant in San Antonio, says strong growth justifies more production. But since **Honda** and **Nissan** can boast that a greater portion of their sales come from North American factories, and Toyota is paranoid about a backlash in the States, the company also figures it must build, build, build.

ONLINE "Toyota's 'Born in U.S.A.' blitz rolls on," www.businessweek.com/go/tbw

Gap Snips Away

Paring back to its core businesses, Gap on Feb. 26 said it will give up on **Forth & Towne**, its 18-month-old clothing chain aimed at women over 35. The tattered retailer said Forth & Towne, which runs 19 stores and competes with established outfits like **Talbots** and **Chico's**, "was not demonstrating enough potential."

Airbus' Flight Plan

The planemaker finally laid out its route to recovery. **CEO Louis Gallois** on Feb. 28 unveiled a plan that involves laying off 10,000 and divesting six plants in France and Germany to save \$2.8 billion over four years. French unions lambasted the proposal as "an act of war."

ONLINE "Airbus: Restructuring at full throttle," www.businessweek.com/go/tbw

GLITCH OF THE WEEK

Specialists, the folks on the floor of the **New York Stock Exchange** who help settle chaotic markets, have long been derided as dinosaurs. Advocates of superfast computerized stock trading have had their way at the Big Board and other markets worldwide in making the floor almost irrelevant. But with computer glitches helping turn the Feb. 27 slide into a 416-point rout, the dinosaurs are getting their revenge. Without them, "the decline would have been far worse," says **Robert Fagenson**, chairman of one of the biggest specialist firms, **Van der Moolen**. They were buying as investors were rushing to sell, keeping prices from plunging further. He and other specialists are likely now to get a better hearing as NYSE officials and regulators mull more computerization. The NYSE recently began implementing a hybrid system that puts computers largely ahead of specialists, and technology argue it's only a matter of time before the human touch is eliminated. But the meltdown, Fagenson says, amounts to "a good argument for manual intervention."

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WHAT THE MARKET IS TELLING US

Volatility is back. Ominous signs loom. But the outlook for U.S. markets is surprisingly upbeat. **BY ROBEN FARZAD AND DAVID HENRY**



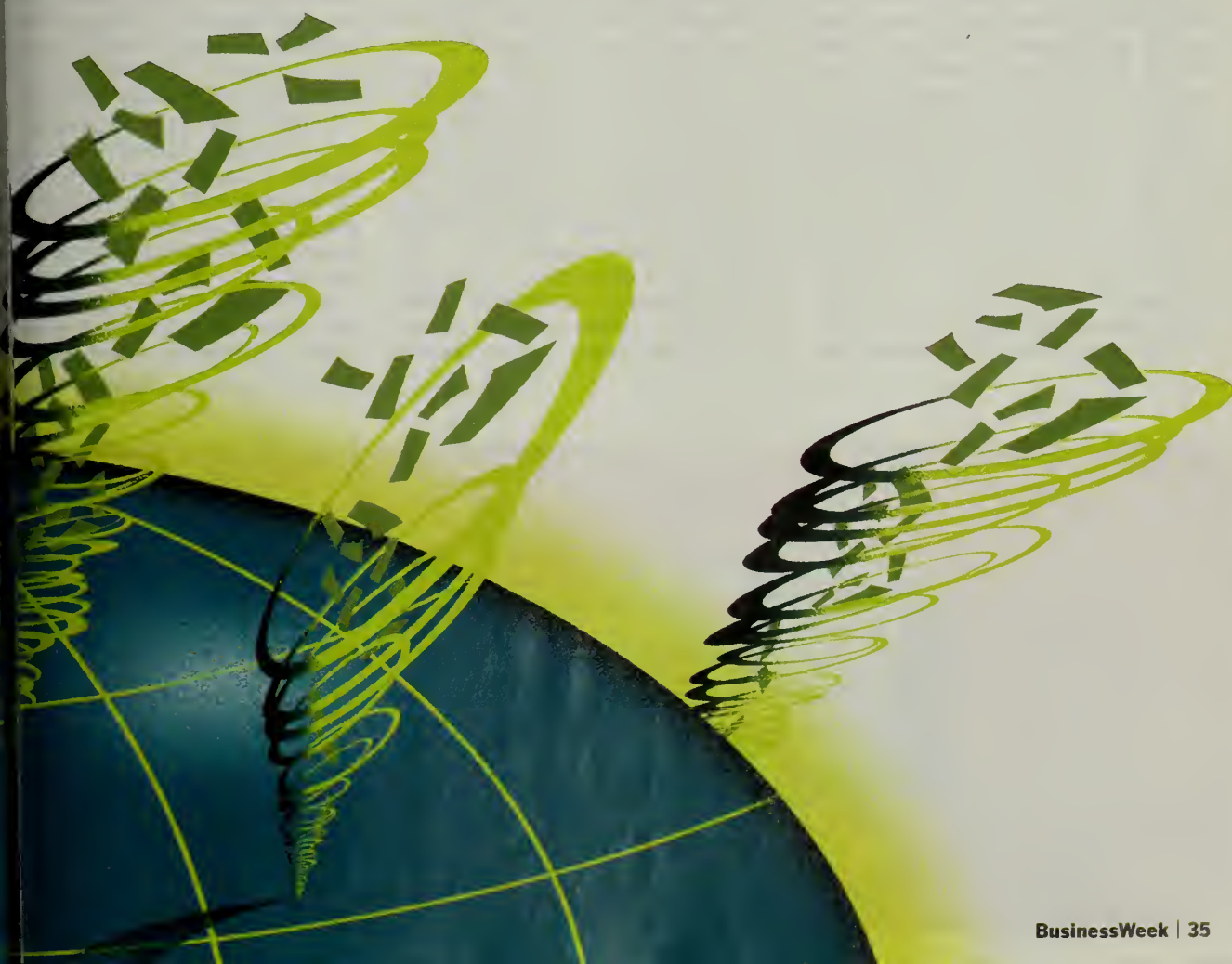
In the parlance of Thomas Friedman, the world never looked flatter than it did this week. A 9% stock market sell-off in China on Feb. 27 prompted sharp drops almost everywhere else around the globe. Suddenly, money managers and traders, lulled into a trance by seven months of steadily rising share prices, felt like they'd been hit over the head with a best-selling hardcover. With one big thwack, they were reminded that stocks are risky and emerging markets are riskier.

In hindsight, no one should have been surprised. China surged an amazing 130% last year and 13% in the week ahead of the plunge, as lions of newbie day traders punched in buy orders on rumors about res they'd never heard of. Stocks zoomed in other overseas markets half a year; U.S. shares, which have lagged the rest of the world since 2000, rose steadily and with little volatility. Something had to give.

The question is what happens next. This latest episode of jitters could be the opening shock-and-awe campaign of something more big. The U.S. economy is suddenly looking weaker than it has in a long time. Fears are mounting that troubles in the mortgage market could spread to other sectors. And profit growth seems to be slowing markedly—a troublesome sign, to be sure.

But a stronger case can be made that Feb. 27 will turn out to be more of a tremor than an earthquake. Notably, U.S. indexes gained on Feb. 28. That's in part because powerful forces are undergirding stocks now in a way they weren't in earlier bear markets. The last bear came on the heels of a long bull market that included the biggest five-year run-up since the 1920s. Share prices are only now beginning to revisit their 2000 levels. The amount of cash sitting on the sidelines is at a record. Individual investors haven't jumped into the market en masse.

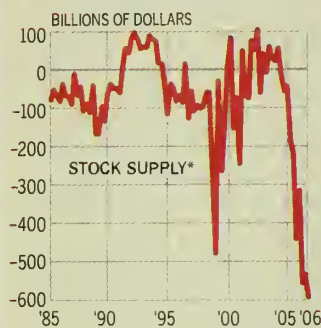
What's more, private equity is now a major factor. Buyout firms have raised billions in the past two years. Furious dealmaking is keeping asset prices buoyant and also cutting the supply of shares available to investors. That squeeze is being magnified by activist hedge funds, which are badgering companies into stock repurchases like never before. With the inventory of equities down and so



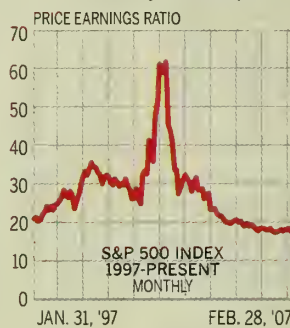


THE BULLS' CASE

Stocks are scarce...

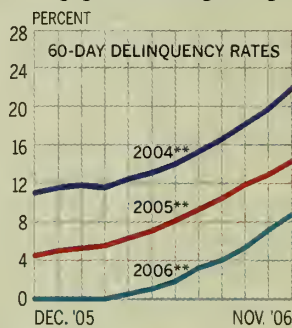


...and they're cheap



THE BEARS' CASE

Mortgage woes are growing...



...while business spending weaker



much money already on the sidelines, the market appears to have a steady floor underfoot.

AMERICAN ADVANTAGE

ONE THING IS FOR SURE: Volatility is back. Bulls and bears will battle it out over the next few weeks and months, not only in the U.S. but also abroad. That could actually be good news for U.S. stocks, at least relatively speaking. As fund managers and traders recalibrate their risk appetites, U.S. stocks stand to look more attractive than their overseas counterparts. In fact, the riskier those markets, the safer the U.S. will seem. In short, the world could seem a lot less flat—in a hurry.

The biggest support for the U.S. market has been, and will likely remain, pri-

Maria Bartiromo talks with China expert Don Straszheim. FaceTime page 106

vate equity firms and hedge funds. The \$45 billion privatization of utility TXU announced on Monday—the biggest of all time—was the second record-setting deal in three months. Eight of the top 10 LBOs in history have been inked since June; in 2006 alone some \$420 billion in leveraged buyouts took place, a record. And yet private equity firms still wield as much as \$2 trillion in combined buying power, enough to take out fully a 10th of the entire U.S. stock market.

The fuel for all the buying—low long-term interest rates—remains in the tank. In fact rates have been falling in the past few weeks and fell even more Tuesday,

making the debt, or leverage, that private equity firms wield even cheaper. “The difference between cost of capital and return on equity is so enormous that if you’re a leveraged player you just have to buy,” says market watcher Jason D. Trennert of Strategas Research Partners. He goes so far as to suggest that the Standard & Poor’s 500-stock index itself, if it could be packaged as a single entity, would be a screaming LBO candidate. Hence what veteran market strategist Edward E. Yarnall has taken to calling the “private equity put”—for put option, a floor price under a security. In this case it’s under the whole market.

At the same time activist hedge funds are helping to reduce the supply of shares available to investors by “er-



companies with lengthy lists of hands that usually include buybacks. They've helped compel 29 of the 30 members of the Dow Jones industrial average to repurchase shares in recent years. According to Thomson Financial, last year's \$370 billion in buybacks was more than four times the total of 2003. All told, Strategas calculates that the record \$600 billion in U.S. shares were removed from the public market in the first nine months of 2006. Liquidity bolsters the value of the shares that remain.

Here's another important reason the bulls aren't sanding down their noses: Mom-and-pop enthusiasm for the U.S. stock market has been anything but overwhelming, sparing the market a retail-driven froth. While the so-called smart money is gorging, ordinary investors are only nibbling. Consider an anecdote by way of Michael A. Dubis, a Madison (Wis.) financial planner. After sending clients an e-mail to reassure them following Tuesday's market drop, he reports, "I haven't gotten a single call." Citigroup equity strategist James Levkovich notes that his proprietary blend of indicators had investors in "panic" mode well before Tuesday's plunge; many still haven't gotten over the 2000 bear market.

Meanwhile, individual investors are going on mounting cash. Year-end Federal Reserve data showed just under \$5 trillion is stockpiled in savings, money market accounts and retail certificates of deposit, a record stash. Contrast that with China, India, and other emerging markets where the equity culture is spreading like locusts. Day trading, a distant memory in the U.S., is



surging in exotic locales.

To the extent that U.S. mutual fund investors are interested in stocks at all, they're interested in foreign ones. According to fund-flow tracker TrimTabs Investment Research, last year saw U.S. funds draw just \$20 billion in inflows, compared with nearly \$150 billion dedicated to hot foreign investments. If there are excesses in global markets, they're far more pronounced overseas than they are in the U.S. And if history is a guide, the U.S. market is where investors will run if and when emerging markets get choppy.

There's also a good old-fashioned valuation argument to be made for the U.S. Stocks are trading at 17 times earnings—roughly what they changed hands for in 1995. This is another floor under the market explains Stuart T. Freeman, chief equity strategist at A.G. Edwards & Sons Inc. "It tells you that there are reasons why value investors will step in on rough days at these levels."

That's not to say Feb. 27 wasn't

frightening. Chinese regulators jarred investors by raising concerns over the ease with which investors were borrowing money to buy stocks. And former Federal Reserve Chairman Alan Greenspan warned of excessive risk-taking and hinted at the possibility that the U.S. economy might slip into recession by the end of 2007—a prediction bolstered by fresh economic data (chart, left). Those twin events sent all of emerging marketdom plunging. European stocks slid by 2.6% in sympathy. The Dow's one-day plunge of 416 points was its steepest point loss since the market opened after September 11.

OH, WHAT A DAY
An NYSE trader watches the market close on Feb. 27

The bears, emboldened by \$583 billion in evaporated U.S. market wealth—which wiped out gains for the year—came out of a prolonged hibernation to growl a chorus of I-told-you-so's. "It was a wake-up call from the complacency of a mature economic expansion," says James B. Stack, president of InvesTech Research, an investment advisory service based in Whitefish, Mont. "When you have a market that basically goes up and up over what has been a four-year period, investors tend to lose the perspective that stocks are not riskless."

Over the years there have been far bigger market drops in percentage terms. In 1987 the S&P 500 plunged 21% in a single day; it dropped just 3.5% this time. And the U.S. market is still far from an official correction, much less bear market territory: Through Wednesday, the S&P 500 was down just 4% from its recent high. A full-fledged correction is defined as a

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10% slide; a bear market, a 20% drop.

Nevertheless, Tuesday's rout shook investors from a cocoon of complacency. It ended the longest stretch in 107 years that the Dow had not declined by 2% or more in a single day. The last time the market fell 2% was May 19, 2003, two months after the U.S. went to war in Iraq. The pullback had investors contemplating their appetite for global risk and weighing hazards at a time of unprecedented, and, some would argue, untested financial interconnectedness.

In some ways, China's one-day descent wasn't so worrisome. Its market is still up 9% this year. Dissecting investor sentiment in Shanghai is a bit like psychoanalyzing a roulette wheel. A return to

some semblance of normalcy was very much in order. "People were talking about a bubble, so the government was quite worried before this correction," says Chun Chang, professor of finance at China Europe International Business School. "[The sell-off] was pretty big, but we needed it."

Much more troubling for the bears was Greenspan's speech. The R-word isn't thrown around lightly in market circles; coming from Greenspan (even in retirement) it sounds thunderous. Now the idea that the U.S. is about to fall into recession—its first in six years—is gaining traction. Stockbroker Peter D. Schiff, author of the just-released book *Crash Proof: How To Profit From*

The Coming Economic Collapse and purveyor of precious metals, dispenses euphemism altogether: "We've become like heroin addicts; a recession will cleanse us."

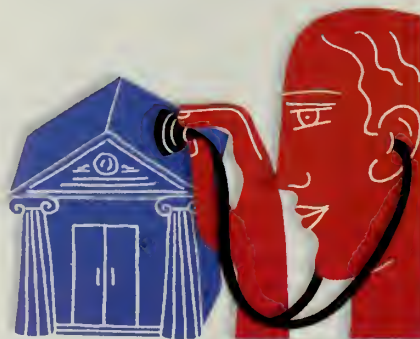
There's no doubt, for example, the multiyear U.S. housing boom is over. Stock prices certainly seem to bode trouble. Shares of subprime lenders such as New Century Financial Corp. and NovaStar have crashed in the month (below). Higher up on the lending food chain, British-based banking giant HSBC Holdings PLC recently admitted its feeling pain. And many U.S. banks are quietly increasing loan-loss reserves. Wall Street analysts and economists have emptied boxes

HOUSING

LENDER WOES GO BEYOND SUBPRIME

BY MARA DER HOVANESIAN

FEW ARE FEELING THE hangover from housing's heyday as much as subprime lenders that cater to risky borrowers. The stocks of such players as New Century Financial Corp. and NovaStar have been slashed, 50% and 63% respectively, since February. But even diversified lenders and mainstream banks have headaches. Countrywide Financial is off 13%, Washington Mutual has slipped 6%, and Europe's HSBC is down 5% since it revealed that its 2006 charges for bad debts would exceed forecasts by \$1.76 billion.



Last year underwriters of all stripes loosened their standards despite a weak housing market. Now adjustable-rate mortgages are resetting to higher rates, and homeowners are falling behind on payments. So some big banks and bro-

kerages are exercising their option to sell risky loans back to their original issuers, usually small, private mortgage brokers and lenders—and plenty of these small outfits have gone belly up.

Even so, big banks' loans are holding. Bad loans, so-called nonperforming loans that include mortgages, rose 1% in December, 2006, vs. December, 2005, says SNL Financial. Some are setting money aside or buying extra insurance to cover losses. Countrywide plans to increase insurance on up to \$19 billion in loans, roughly a fourth of its portfolio. Others, like Freddie Mac, are finding regulators instituting tougher underwriting rules.

MENACING LOANS

BANK / ASSETS (BILLIONS)	CHANGE IN BAD LOANS* 12/06 vs. 12/05	CHANGE IN PROVISIONS FOR BAD LOANS	BANK / ASSETS (BILLIONS)	CHANGE IN BAD LOANS* 12/06 vs. 12/05	CHANGE IN PROVISIONS FOR BAD LOANS
BANK OF AMERICA (\$1,459.0)	16.8%	12.1%	COMMERCE BANCORP (\$45.3)	45.5%	13.8%
WACHOVIA (707.1)	91.7	23.3	TD BANKNORTH (40.2)	116.9	25.4
WELLS FARGO (481.9)	24.5	-2.8	FIRST HORIZON NATIONAL (37.9)	79.2	14.0
SUNTRUST BANKS (182.2)	123.5	4.4	HUNTINGTON BANCSHARES (35.3)	22.9	1.4
BANK OF NEW YORK (103.4)	42.3	-12.0	COMPASS BANCSHARES (34.2)	17.3	8.9
FIFTH THIRD BANCORP (100.7)	19.7	3.6	SYNOVUS FINANCIAL (31.9)	17.6	8.6
NORTHERN TRUST (60.7)	15.2	12.0	ASSOCIATED BANC-CORP (21.0)	43.4	0.0
COMERICA (58.0)	55.1	-4.5	MERCANTILE BANKSHARES (17.72)	37.2	-8.7
M&T BANK (57.0)	44.9	1.9	W HOLDING (17.2)	159.1	37.3
MARSHALL & ISLEY (56.2)	96.5	15.6	AVERAGE** (149.30)	11.00	4.1

*Nonperforming loans **At 56 banks with more than \$1 billion in assets Data: SNL Financial



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toner cartridge in recent weeks opining on what might lie beneath the balance sheets of banks and brokerage houses. There's growing fear that the subprime rot will spread.

Even if you don't subscribe to this systemic worry, market fundamentalists stand next in line to warn of an earnings slowdown. Corporate profits have increased by double-digit percentages for 19 consecutive quarters. But Deutsche Bank points out that first- and second-quarter earnings for U.S. companies are expected to grow by less than 5%, year-over-year. And according to TrendMacrolytics, forward earnings growth could clock in at less than 4%. The last time that kind of decline happened was April, 2000, a month after the start of the bear market and 11 months before the economy fell into recession.

What's more, this bull market is getting long in the tooth. The 48 months it has gone without a 10% correction is the second longest in at least 78 years, according to Stack. Bearish hedge fund manager Doug Kass notes that four-year bull markets that follow deep bear markets, like the one from 2000 to 2002, "often morph into disaster." He points to the 1937, 1962, and 1987 crashes, and the fact that the sixth or seventh year of every decade in the 20th century experienced a crash or steep pullback.

Still, the bulls are hardly ready to repent—and apparently with good reason. Expect a two-front war in the coming months. In the U.S. it'll be a contest between recession-spooked worriers and stockpickers with visions of high-priced buyouts. A parallel fight will pit the freewheeling global markets against the safety of the U.S. Indeed, the events of this week just might spark a resurgence in U.S. shares. "Tuesday could be the shot across the bow for the end of the flow of funds to overseas markets and back to the U.S.," says Bernie Schaeffer of Schaeffer's Investment Research Inc. One market-agnostic growth fund manager says he just got those very marching orders from his supervising investment committee: "We're in the process, even if it doesn't necessarily finalize next week or next month."

And that would show that the world might not be so flat after all. ■

—With Mara Der Hovanesian in New York, Chris Palmeri in Los Angeles, Dexter Roberts in Beijing, and Frederik Balfour in Hong Kong

COMMENTARY

BY CHRISTOPHER FARRELL

How Alan Helped Ben

He sounded an alarm the Fed couldn't

WHAT DOES FEDERAL Reserve Board Chairman Ben S. Bernanke think of his illustrious predecessor now? For weeks, Bernanke has been reassuring Washington and Wall Street that the economy is healthy and inflation pressures are diminishing. Yet Alan Greenspan comes along and helps ignite a global market firestorm by talking about the risks of recession in America. Is Bernanke feeling dissed by a living legend?

stock market is one of the fastest growing in the world, up 52% to date. Bernanke and the other governors have crisscrossed the country openly worrying about excessive risk taking and investor complacency to no avail.

Maybe investors will pay more attention to Greenspan. In the speech where he talked about recession, he also said, "We have extraordinarily low risk premiums now. Risk is no longer perceived as a major risk, at least as it was in years past, and that, I must say, I find disturbing."

The Fed has been silent for years on how to react when the market seems an asset-price bubble is emerging. In 1996, Greenspan fretted about "irrational exuberance" in the stock market, but his jawboning had little impact. Sentiment soared into record territory until crashing in 2000. Greenspan was criticized for not raising interest rates to burst the bubble.

This time around, investor enthusiasm for assets is growing, and the danger is that risks are being systematically underestimated.

Yet Bernanke is in a tight spot. He hikes interest rates, he risks turning an implosion in the subprime mortgage market into a housing market collapse. The economy wouldn't be far better. It's a far better tactic for a legend schooled in the risks of bubbles to sound the alarm.

Certainly everyone has a better appreciation of capital market risk in the events of this week. We'll find out in the weeks ahead whether jawboning works this time around. ■



"Risk is no longer perceived as major risk, at least as it was in years past, and that, I must say, I find disturbing."

—ALAN GREENSPAN

I doubt it. Of course, I don't know for sure, and neither Greenspan nor Bernanke is talking about their relationship. Yet I bet Bernanke is mouthing a silent thank-you to his predecessor. Greenspan just made Bernanke's job a bit easier.

The reason lies with a four-letter word: risk. Pension funds, hedge funds, private equity pools, and other investors are scouring the globe seeking higher returns. A tidal wave of foreign investment has poured into Brazil, China, India, and Russia. But it isn't just emerging-market giants that have attracted money. Vietnam's



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GLOBAL MARKETS

CONTAGION? NO, WAKE-UP CALL

It's not the '90s, but it's a good time for investors to pull back from Asian markets

BY PETE ENGARDIO

PRETTY MUCH EVERYONE knows the Shanghai stock exchange is a casino. So after Chinese speculators propelled the bourse up by 135%, what's a measly 9% dip? To global markets, it apparently matters a great deal. Minutes after rumors of a government tax-policy shift triggered selling in Shanghai, investors began fleeing emerging markets from Mexico City to Mumbai. On Wall Street, already jittery over mixed economic news, China provided the spark for the steepest one-day dive in stock prices since March, 2003.

Is emerging market contagion back? Yes and no. Some sharp pullbacks are certainly way overdue. "We've had four straight years of record results for emerging markets," says Mark W. Headley, a

portfolio manager at the Matthews Asian Funds. "Why on earth should we expect a fifth straight year?" It's been a smooth ride for these markets, and many forget that these are still immature bourses lacking a savvy local investor class to give them a firm foundation.

But don't expect a repeat of the kind

of global meltdowns that swept Asia, Latin America, and Russia in the late 1990s. True, a number of markets are clearly overbought. Venezuela's market soared by 79% in the past 12 months, while those of Peru and Vietnam are up a score of 158% and 182%, respectively. Foreign investors—who tend to cut and run at the first moments—are a major factor. In 2002, just before the boom, \$2 billion was yanked out.

The similarities with the go-go '90s are there, though. In times past, developing nations were famous for their reckless public finances and balance of payment problems. "Now, most of these countries are pursuing prudent policies and running budget surpluses," says Savard, the Institute of International Finance's director of global economic

IN MUMBAI
Asian economies are growing more prudently

EMERGING-MARKET RISK

Some potential pitfalls for investors in 2007

INCOMPLETE REFORMS Mexico, Brazil, and Turkey must do more to curb the state's role in the economy. Turkey needs to work on its trade deficit.

POLITICAL PERILS Fiscal discipline may waver as Argentina, Turkey, and the Philippines face elections. A Russian Presidential election looms.

DEBT DEFAULT Ecuador will likely seek to restructure its international obligations.

NATIONALIZATION Venezuela is stepping up its drive to expropriate companies in key industries and asserting its role in the region.

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sis. The top 40 emerging markets last year ran current-account surpluses equal to 3.2% of gross domestic product, compared with 0.5% in 2002.

Yet even if we don't get Asian Crisis Part II, we could get The Year of Volatility, especially if investors keep pumping funds into markets like China's, where machinations by a handful of players can lead to wild swings. "The Shanghai market drop is a reminder that emerging-market stocks are a volatile asset class," says Donald Elefson, a portfolio manager of Excelsior Emerging Markets Fund.

Chinese stocks certainly seemed poised for a hit. China's export boom, loose-money policies, and huge inflows of foreign capital have produced an enor-

mous liquidity bubble. Even after their 9% dive, says portfolio manager Romeo Dator of U.S. Global Investors Inc., Shanghai A shares trade at 36 times earnings. As authorities struggle to talk the market back to earth, Chinese stocks will remain high-risk bets. "The fear is that they will take one step too far and take the whole market down."

DEFENSIVE INVESTING

WITH SUCH JITTERS in the air, it's a good idea for investors to pull back. "This correction will take time to unfold," says Arthur Budaghy, managing editor of BCA Research's emerging market newsletter. Stocks in China, the Philippines, and Argentina appear especially vulner-

able, he says. Yet while stocks could rebound 10% off their recent highs by rebounding, that's far less severe than the 25% plunge most emerging markets experienced in the summer of 2002 after a spike in 10-year U.S. Treasury bonds sparked worries of rising inflation.

Even the prospect of a 10% pullback, though, is prompting Headley to defensive action. He is shunning Indian and Chinese stocks, some of which he figures could still decline by 50% instead loading up on low price-earnings plays like Korean banks. "I've been here before," Headley says. "And when music stops, it isn't pretty." ■

—With Christopher Power in New

CHINA

DOING THE SHANGHAI SHUFFLE

The swoon in stocks won't slow down the Chinese growth machine

BY BRIAN BREMNER

THE BROKERAGES IN Shanghai were packed to the gills on Feb. 27, as anxious small-time investors gathered in tense silence to watch their holdings dwindle.

But the rest of China—the China that makes shirts, assembles electronics, manufactures cars, and forges steel—barely noticed. China's growth remains intact, and the swoon in the Shanghai bourse will do little to slow it down.

How so? For starters, China's shareholder class, though expanding rapidly, is relatively small, so a wipeout in stocks won't affect broad trends like consumer spending and investments in factories. Most Chinese have their savings stashed in bank deposits rather than stocks: Only 9% of household assets are in stocks. So the market turmoil will have little



impact on China's \$2.7 trillion economy. The country is still on track to post 9.1% in 2007, and likely will soon overtake Germany as the world's third-biggest economy. China is not going to take the world economy down with it, at least not this time. The effect of the Feb. 27 plunge "on global growth is approximately zero," Standard Chartered Bank senior economist Stephen Greene wrote in a note to clients.

China still has plenty going for it. Wages have risen enough to give a projected 8% boost in consumption this year. Yet the economy remains competitive, with labor costs still a fraction of those in the West. Beijing is booming as the capital revs up for the 2008 Summer Olym-

pics. Chinese corporations are reporting profit gains of 40% on average. Some sectors are winning some pricing power. In late January, Baoshan Iron & Steel forecast a hefty rise in steel production in 2007 and raised prices by about 5% in response to strong demand. Finally, the government is spending to boost incomes and living standards in the country's interior.

Stock gyrations, however savage, will have little impact on these trends. China's stock bourses, in fact, performed dismally last year—with no visible effect on the country's growth. The losses of February in Shanghai don't hold a candle to the 2007 record in 2007.

The real danger to investors is not a stock market crash but a Chinese monetary policy that grows so fast the government has to intervene and slam on the brakes. That happened in the 1990s under the premiership of Zhu Rongji, who tamed inflation but slowed gross domestic product growth to a crawl. Indeed, one of the precipitating causes of the 1997 Asian crisis was the People's Bank of China's decision to drain liquidity from the economy by requiring banks to park more cash at the central bank. Monetary authorities are worried about the rapid expansion of consumer lending and other excesses.

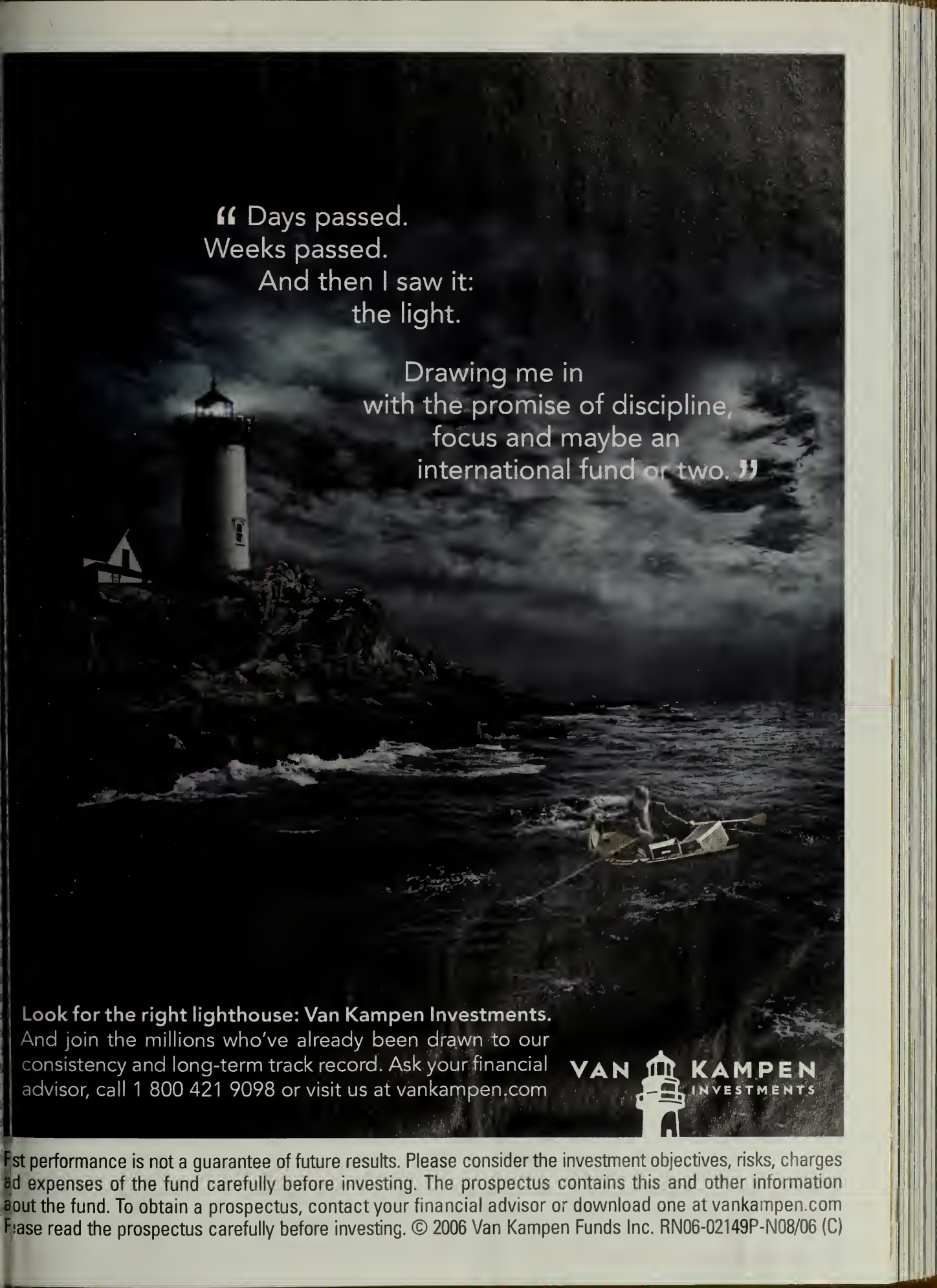
So the PBOC may have to slow up with an interest rate hike soon. And the government may have to reduce capital-gains taxes on real estate transactions to curb bank lending. China still has plenty of risks. But don't let the real trouble on the floor of the exchange. ■

CHINA'S MIGHT

GDP Growth
9.1%*

Foreign Reserves
\$1.2 trillion**

*2007 forecast **Yearend 2007
Data: HSBC Holdings PLC



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CONTROVERSIES

HOMING IN ON TRADING ABUSES

Do allegations that a UBS worker sold info to hedge funds signal a growing problem?

BY MATTHEW GOLDSTEIN

IT'S NO SECRET THAT HEDGE FUND managers are always looking for an edge before betting on a stock. Often that entails a lot of hard work such as digging through patent filings, scouring court records, and talking to former employees of a company. But in an effort to score an easy profit, some traders, it seems, may be willing to break the law by paying for confidential information.

Case in point: the allegation, first reported by BusinessWeek.com on Feb. 26, that federal authorities are on the verge of charging an employee in the New York office of Swiss investment bank UBS with selling unpublished information about changes in analyst ratings on stocks to traders at two hedge funds. UBS declined to comment. Investigators also believe employees at another big investment firm got wind of the impending ratings changes at UBS and traded on them. The alleged inside information all but

guaranteed a profit for the traders given the potential power of ratings changes to move stock prices. The emerging insider trading scandal comes just four years after 10 Wall Street firms paid \$1.4 billion to settle charges that some analysts had conspired with investment bankers to issue favorable ratings on certain stocks.

The possible misdeeds by a UBS employee are merely the latest variation on a long-running theme; for the right price, market-moving information can often be bought. Several former executives of day-trading firm AB Watley Direct Inc. will stand trial this month in a federal court in Brooklyn, N.Y., on charges that they orchestrated a scheme to eavesdrop on the chatter at the institutional trading desks of Merrill Lynch, Citigroup, and Lehman Brothers. Joining the Watley executives at the defense table will be the

former brokers who allegedly made the scheme work by selling access to the firms' "squawk box" communications systems, which allowed the day trader to listen to the conversation.

Regulators don't believe those are isolated cases. In fact, the Securities & Exchange Commission is concerned about the misuse of confidential trading information that in early February it launched an inquiry to see if brokers at a dozen major Wall Street firms improperly tipped off hedge funds about big trades by institutional investors. Regulators are naming UBS, Merrill Lynch, Morgan Stanley, Deutsche Bank, and other banks to provide

data on all stock and option trades for the firms and their customers from the last several weeks of September. The feeling on Wall Street is that the SEC is on a fishing expedition. Yet some securities attorneys say regulators may have been tipped off to specific incidents, given the targeted request.

MARKET MOVERS

IT'S EASY TO SEE why regulators are worried. Big trades can move prices dramatically, and a hedge fund with advance notice can make a killing. Mutual fund companies for years have complained to regulators that Wall Street brokers were passing on tips about such trades to favorite customers. And when broke hedge funds trade ahead of other institutional investors, it usually means mutual funds and pension funds are getting lower prices when they buy or sell shares.

Hedge fund advocates say regulators are overreacting. They argue that only a few bad apples resort to cheating or eavesdropping, and contend that most of the hedge funds' information comes from good-fashioned detective work. "Regulators are suspicious of the hedge-fund industry and apt to jump to the conclusion that a manager's behavior violates the law," says Jeffrey Geffner, a partner with

Geffner, a partner with the New York City law firm of Geffner, Goldberg, & Goldberg, a New York City firm with a large hedge fund practice. While that may be, each new allegation of a hedge fund paying for inside tips only reinforces the feeling that the playing field is unbalanced and needs to be rebalanced.

A fund with advance notice about a block trade can make a killing



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STUMBLES

IS JETBLUE THE NEXT PEOPLE EXPRESS?

As its Valentine's Day debacle shows, ferocious growth can be crippling

BY DEAN FOUST

SOME YEARS AGO, A charismatic entrepreneur started a low-cost airline to reinvent the flying experience. With its hub at an underserved New York-area airport, the upstart carrier became the talk of the industry—and grew so fast that in a few years it ranked as fifth-largest. Its founder was lauded as a visionary.

JetBlue Airways Corp.? Actually, it was now-defunct People Express Airlines, which like JetBlue enjoyed meteoric growth in its early years. After JetBlue's meltdown at JFK Airport during a Valentine's Day ice storm, which left hundreds of passengers stuck on planes for as much as 11 hours, the parallels are even more striking: At both, rapid expansion outstripped management's ability to keep everything together.

JetBlue's executives

TOO MUCH

JetBlue expanded fast, then had to cut costs

were clearly chastened by the experience. Chief Executive David Neeleman said afterwards he was "sorry and embarrassed," assuring customers "it will never happen again." But industry insiders believe the JFK debacle was inevitable. After seven years of nearly unbridled growth, the \$2.4 billion carrier was slow to upgrade operational systems that could have minimized the problems. "They can't keep running off a legal pad and No. 2 pencil," says a longtime industry executive.

JetBlue's fortunes started to unravel when it lost \$32 million in the first quarter of 2006 because of rising fuel costs and moves into new markets. Neeleman cut costs and was back in the black by the next quarter. But the result, say industry insiders, was that necessary upgrades to its systems weren't completed, leaving the airline unable to juggle flight delays like the ones at JFK.

Already overburdened crew scheduling systems failed, so flight crews weren't rerouted to their next assignment. The reservation and call-center systems still haven't been updated, some say.

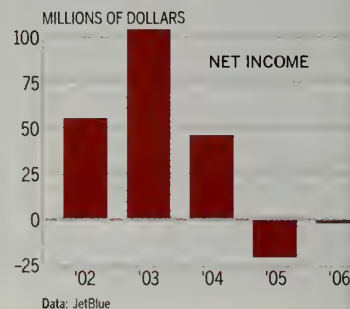
JetBlue "may have been too aggressive cutting costs," says Ray Neidl, a Cal Securities USA Inc. analyst. A JetBlue spokeswoman attributes the problem to human error. "I wouldn't say our system failed," she says.

TURBULENCE AHEAD

FOR NOW, NO ONE thinks JetBlue will go the way of People, which was forced to offload assets in 1987 after its disastrous acquisition of Frontier Airlines. New York-based JetBlue, with \$699 million in cash, has a far stronger balance sheet. Equally important, the carrier started easing off its growth plans. In December, Neeleman pushed back delivery of 36 Embraer and Airbus jets until the next decade, though he's on the list for 22 planes this year.

Still, analysts believe JetBlue will face more headwinds than in its first several years, when major carriers were in business.

THE JETBLUE BLUES



ruptcy and too weak to defend their market. To keep growing, the carrier needs to expand outside its New York stronghold, and analysts think few areas are available. "They've got a lot of planes on order, but there aren't many markets you can throw 150-seat airplanes into," says aviation consultant Mike Boyd.

What's more, its current fleet will need costly maintenance, expenses JetBlue may be underestimating. Union pilots could be an issue as JetBlue recruited them with stock options that more than made up for below-average pay and longer work hours with the stock now 60% off its 2003 price. Pilots may feel the pinch. "I would be surprised to see union organizing later this year," says consultant Sam Klaskin. So JetBlue must deal with growing pains or risk going the way of People Express. ■

BusinessWeek .com

ONLINE: To join a debate on airline passengers' rights, go to www.businessweek.com/extras.

jetBlue

PHARMACEUTICALS

WHEN THE GOING GETS TOUGH...

As boomers age, more drugs are sold for bladder woes and other unmentionables

ARLENE WEINTRAUB

IF YOU HAVE SAT THROUGH A string of drug ads on TV recently, you've probably heard a lot about "going" problems. One ad gently asks if you are always waking up to go. Another suggests that you have to go urgently, but once you get there you find you can't go at all. You're imagining it: In 2006 pharmaceutical companies poured \$238.8 million in ads for drugs to treat those embarrassing symptoms, including Flomax for prostate trouble and Vesicare for bladder issues. That's 37% more than the industry spent pitching such drugs in 2005, according to TNS Media Intelligence.

Don't expect the ad stream to slow anytime soon. The frequent urges that used to be considered a natural byproduct of aging have become the drug industry's disease *du jour*. Novartis and GlaxoSmithKline Co. recently kicked off a campaign for Enablex, a drug to treat overactive bladder. The TV ad features animated water balloons representing, yes, you know. Boehringer Ingelheim, which makes Flomax, introduced its latest ad during the Super Bowl. It depicts a cycling and kayaking baby boomer looking happy, one assumes, because he doesn't have to find a bathroom.

The ad assault is working. Prescriptions for Flomax were up 20% in 2006, according to IMS Health. Prescriptions for GlaxoSmithKline PLC's Vesicare—its ads feature animated pipes that represent urinary plumbing—were up 12%, while Glaxo's prostate drug, Avodart, rose 94%. Total sales of drugs to treat bladder and



prostate issues are \$1.5 billion and \$4 billion a year respectively, and growing at double-digit rates.

Pfizer Inc. might launch a new drug for overactive bladder later this year, and its approach will be closely watched. It was Pfizer that first implored TV viewers to talk to their doctors about touchy symptoms when it launched Viagra in 1998, bringing the term "erectile dysfunction" into everyday banter. Then there was Detrol, the bladder remedy Pfizer marketed with a jingle that went, "Gotta go, gotta go, gotta go right now." Although the ad was lampooned by comedians, Detrol became a \$1 billion hit.

Some drug industry critics say the real "growing problem," to quote the Avodart ad, is not America's need to go. Rather, it's the relentless pressure drug-makers place on boomers to take more pills. Often such symptoms are nothing more than a nuisance of aging. "As men get old-

er, their prostates get larger. They also go bald," says Michael Palese, assistant professor of urology at Mt. Sinai School of Medicine in New York. The ad blitz, he says "is irresponsible."

BREAK THE SILENCE

JEFF HUTH, SENIOR vice-president for marketing at Boehringer, says he and his colleagues debated the value of direct-to-consumer advertising for Flomax. In the end, they couldn't ignore the statistics: Half of all men over age 50, or about 20 million men in the U.S., have the condition the drug treats, enlarged prostate. Because they have to get up frequently at night, they often suffer sleep deprivation, Huth points out.

But less than 15% of them are being treated. "Many men are suffering in silence," Huth says. "The ads help them recognize this is a treatable condition."

Execs at P&G hope the water-balloon image for a misbehaving bladder will make its drug Enablex stand out in a crowded field of ads employing "gotta go" euphemisms. And they defend direct-to-consumer marketing as an important way to make people more comfortable talking about taboo topics. About 17 million men and women in the U.S.

have bladder problems. "Incontinence is embarrassing and has emotional consequences," says spokeswoman Elaine Plummer. "This is a lighthearted way to open the discussion." Some doctors also say the ads are driving more people to seek medical advice, leading to earlier detection of serious problems such as cancer or blockages that need to be fixed with surgery.

The debate is bound to get noisier, judging from the number of new gotta-go drugs in development. Allergan Inc., for example, is testing Botox to treat overactive bladder. And scientists are experimenting with mixtures of drugs that are already on the market. If they work, companies will be able to patent the combos as new drugs. You know what that means: more pipe people, balloons, and no-longer-embarrassed boomers will be parading across our TV screens. ■

PIPING UP Ads for Glaxo's Vesicare play on the idea of faulty plumbing

THE STAT

\$238.8 million

*Ad dollars spent on drugs to treat urological disorders in 2006, up 37% from 2005

*Through November
Data: TNS Media Intelligence

NORTH AFRICA

THE OPENING OF LIBYA

Harvard professor Michael Porter is helping to restructure the economy, but skepticism abounds

BY STANLEY REED

MOHAMED ZEYANI IS a baby-faced 27-year-old with slicked-back hair. He is also a new phenomenon in Muammar al Qaddafi's Libya—an entrepreneur. With his 25-year-old brother Ali, Zeyani opened the Al Sahab Training Center three years ago in the up-and-coming Bin Ashour district of Tripoli. The center is now teaching English, computers, and business skills to about 130 employees of local companies and multinationals such as Occidental Petroleum Corp. and Italian oil giant ENI. “We chose the field of education because we felt there was a big need,” Zeyani says as he looks in on classrooms crowded with women in head scarves and young men in suede jackets. His annual revenues have already doubled, to \$1 million, and he’s thinking of setting up an executive MBA program.

Entrepreneurs in Libya? Isn’t this the pariah state where everything is run by so-called peoples’s committees and until recently private property was severely restricted? The answer is that Qaddafi has wised up—at least partly. He began changing course a few years ago when oil prices were low. The Libyan economy was close to collapse after more than a decade of U.S. and U.N. sanctions brought on by his reckless actions, such as the 1988 bombing of Pan Am Flight 103 over Scotland. After the U.S. invaded

Iraq and toppled Saddam Hussein in 2003, Qaddafi settled his differences with Washington and abandoned his weapons of mass destruction programs.

Since then, foreign oil companies have been piling into Libya, and Tripoli has started to revitalize the economy. Much of the progress is due to an unusual partnership with Harvard Business School professor and competitiveness guru Michael E. Porter, who is advising the Libyans through Boston consultancy Monitor Group.



QADDAFI'S SON Saif al Islam is a champion of business

For the past two years, more than a dozen Monitor consultants have been working in Libya, studying the economy and running a three-month leadership program intended to create a new pro-business elite. So far, 150 Libyans have graduated. The people in the course “were real role models, starting businesses, contributing to society,” says graduate Yazid el Shaari, an engineer at Canadian-Libyan joint venture Veba Oil Operations.

Porter was persuaded to take the job by Qaddafi’s son, Saif al Islam. The former London School of Economics graduate student is a lean man who favors expensive European suits and Western-style economic reform. Since first meeting Saif at several dinners in London, Porter has

traveled to Libya three times and met government officials, including the e Qaddafi. “I didn’t take this on because this is a big economy,” Porter said in an interview at Tripoli’s glitzy Corin Hotel. “It was very symbolic. If this be successful, then other countries will be able to change.”

It’s a monumental task. Libya is behind the curve in just about everything. Moreover, the country’s economy is more dependent on oil and gas than just about any other. The industry, which employs only 3% of the workforce, accounts for over 60% of gross domestic product. Libya has a higher share than in either Saudi Arabia or Kuwait. Even though Qaddafi, who has ruled since 1969, is taking the country off the private sector, unemployment is still estimated to be as high as 35%. The streets of Tripoli are filled with loitering young men.

LOCATION, LOCATION

YET THERE’S A BUZZ in the Libyan capital these days. Developers are lining up to build the spectacular beaches west of the city, and real estate prices have doubled in the past year. “There is definitely an undercurrent of motion,” says Abdul Bousliem, a London-based Libyan real estate agent. He is scouting real estate and IT deals for Tuareg Capital, a private equity fund set up to invest in Libya and Algeria.

Even if it’s not entirely open for business, Libya seems to be worth the gamble. After all, the country has oil

Libya's Economy At a Glance

2006 estimates

POPULATION

5.9
Million

GDP PER CAPITA

\$8,000

*barrels of oil equivalent Data: CIA World Factbook, PFC Energy, U.S. Energy Information Administration



QADDAFI
Is he really
committed
to reform?

income approaching \$40 billion a year, some \$60 billion in the bank, an attractive location across the Mediterranean from Sicily. So far, the best action is in energy. The Oasis Tripoli—which includes ConocoPhillips, Marathon Oil, and Hess—paid Tripoli \$1 billion two years ago to return to Libyan fields that the U.S. government forced them to give up in 1986. Occidental Petroleum Corp. also re-

claimed its old Libyan acreage in 2005, paying \$133 million up front. The company was the big winner in the first of three auctions that the Libyans have held for new exploration rights in the past two years, paying \$90 million and committing to an additional \$125 million in investment. Exxon Mobil and Chevron have also picked up acreage in the auctions. And Royal Dutch Shell has agreed to a major gas deal. “We believe

Libya will be a very interesting country to work in for the next five to ten years,” says Tawfiq A. Mohamed, chairman of ETE-LAF Oil Services Co., a Tripoli-based company that performs oilfield construction work.

More tourists, too, might be drawn to Libya. An hour east of Tripoli lies one of the world’s great ruined cities, Leptis Magna. Among the largest Roman settlements in Africa, it’s well-preserved and promises to be a key attraction. But getting a decent hotel room or a table at one of the better fish restaurants in Tripoli is a challenge. Oil companies have booked blocks of rooms permanently. And the U.S. Embassy, which reopened last year, is using a floor of the Corinthia as a temporary base while its diplomats find a building site.

The growing stream of businesspeople and visitors is gratifying to hotelkeeper Mohammed Mesbah. He runs the Zumit Hotel, a spectacular hostelry built next to a Roman arch dedicated to Marcus Aurelius in Tripoli’s old city. Mesbah recently spent about \$400,000 renovating the colonnaded structure, which was built in 1816 to house traveling merchants. “I figured my vision may be four or five years ahead of its time,” says Mesbah. But he’s already fully booked on most nights.

REFORM ROADBLOCK

NONE OF THIS MEANS Libya is likely to turn into a new Dubai. Libyan society, which has lived for decades under Qaddafi’s revolutionary populism, probably isn’t ready for that degree of opening. “To change from a socialist culture to a private culture is a big project,” says Saleh Zahaf, a lawyer who advises would-be foreign investors. “It requires a generation.”

Porter complains that reform ground to a halt last year after Monitor recommended a big commitment to education and training and investment in energy, tourism, trade, and construction. One reason: a backlash against proposed layoffs of public-sector workers. A planned privatization of a public-sector bank called Sahara also failed when investors rejected the government’s valuation.

Qaddafi and his son needed more time to build consensus. Over the past year, they have gradually replaced hard-liners

Continued on page 57

GDP GROWTH	INFLATION	UNEMPLOYMENT	OIL AND GAS PRODUCTION	OIL AND GAS EXPORTS	PROVEN OIL RESERVES
7.1%	3.1%	35%	2.0 Million Barrels/Day*	\$34.9 Billion	42 Billion Barrels



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SIDE INNOVATION



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BusinessWeek

ACUMEN FOUNDER JACQUELINE NOVOGRATZ



What will we put our stamp on next?

Pitney Bowes mailstream solutions use satellite imagery to let you see customers in unprecedented detail.

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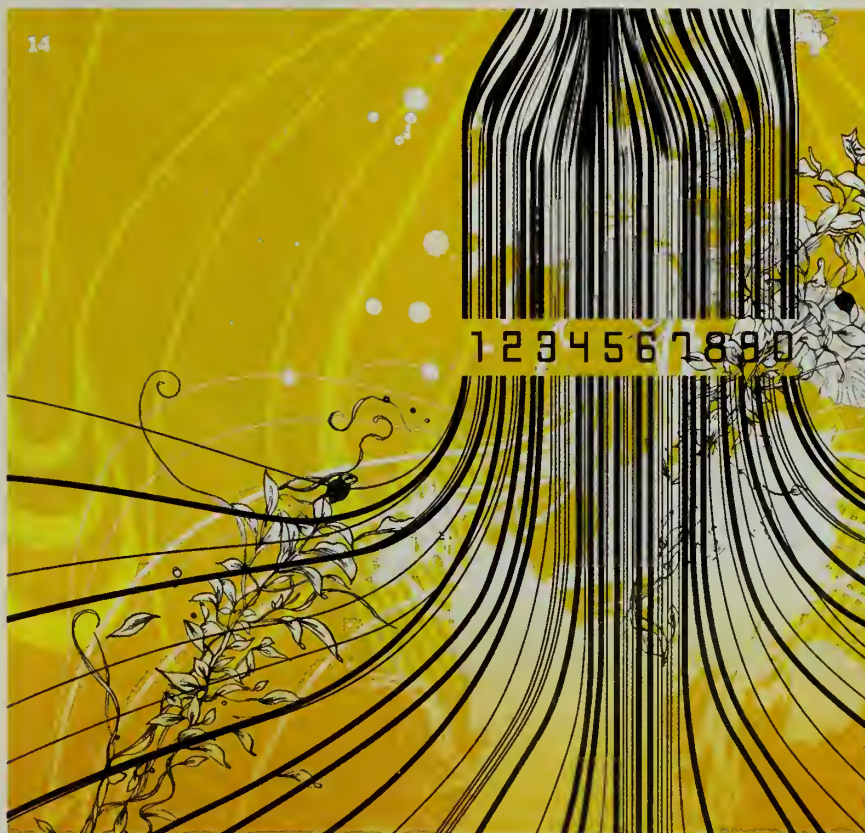
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0 inshort

Cool tools—and the latest trends

0 innetworking

The novelty of MySpace may be over, but companies are collaborating on the Web for all kinds of practical uses

0 incars

The race is on to build a car that gets 100 mpg—and win a \$25 million prize

08 insocial

DESIGNING CHANGE

How venture philanthropy fund Acumen cracks real-world problems



14 indepth

WILL THIS SCAN?

Symbol Tech was shattered by corruption. But herculean efforts to revive the bar code maker, now part of Motorola, might pay off

22 ingreen

Bank of America's clean green tower

24 inprogress

When GE turned to students for design ideas, they came up with some user-friendly health-care concepts for Africa

26 indesign

Meet Sugar, the face of the \$100 laptop and a revolution in design

28 inbacklash

Enough already with the innovation hype

TOOL: CUSTOM CORPORATE GAMES

Executives are using 3D online, multiplayer environments such as *Second Life* and *World of Warcraft* to teach team-building skills. Now, BreakAway, a leading maker of military and medical simulations used by the U.S. government and top med schools, has created mōsbē, a desktop tool that allows companies to make customized video games for corporate use. Booz Allen Hamilton and other companies have used it (think employee training and crisis control).



TOOL: IDEA-TRADING SOFTWARE

At the end of any brainstorming meeting, people have a hunch which ideas are likely to succeed. Tap into the informal wisdom of meetings with Inkling, a software tool that allows people to create “markets” of ideas and “trade,” or bet, on which ones will win or lose. It’s an engaging way to see how a project’s team members rank, say, designs in terms of their viability. Health-care product maker Abbott Laboratories is among the companies using Inkling. Another Inkling feature not only allows employees to put their own new ideas on the faux market, but also facilitates the payment of (play or real) dividends when those ideas start resulting in real-world financial returns.

TREND: BIG-THINK VODCASTS AND WEBCASTS

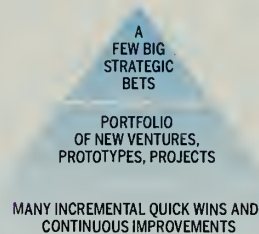
Invites to exclusive conferences such as the World Economic Forum’s annual meeting in Davos, Switzerland, TED in Monterey, Calif., and Pop!Tech in Camden, Me., are hard to score. But video highlights are now available online. Listen to what Azim Premji (right), Wipro’s chairman, said about Indian business strategy in Davos this year (http://gaia.world-television.com/wef/worldeconomicforum_annualmeeting2007). Watch X Prize winner Burt Rutan describe Virgin Galactic’s plans at TED (<http://www.ted.com/tedtalks>). Pop!Tech’s first series of online videos will make its debut in early March (<http://www.poptech.com>).





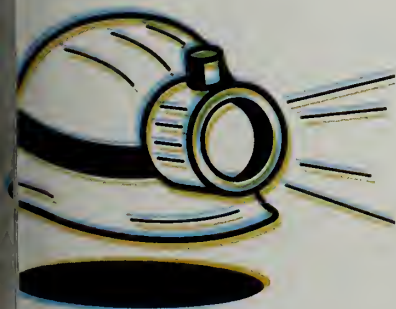
TOOL: INNOVATION PYRAMID

Harvard Business School professor Rosabeth Moss Kanter has come up with a simple strategic tool she calls the Innovation Pyramid. After decades of researching patterns of innovation success among leading companies, Kanter notes that winning innovators prioritize and balance their investments in new or improved products and services in a similar manner. When listed, they form a graphic similar to the U.S. Agriculture Dept.'s nutrition pyramid. Kanter's Innovation Pyramid features a few big gambles at the top, a wider set of fresh prototypes and ventures in the testing stages around the middle, and a broad range of early-stage projects and improvements on existing ideas or products at the pyramid's base. The Innovation Pyramid allows managers to monitor quickly their portfolio of risk. The idea is to have a variety of new concepts in play with varying degrees of risk and returns.



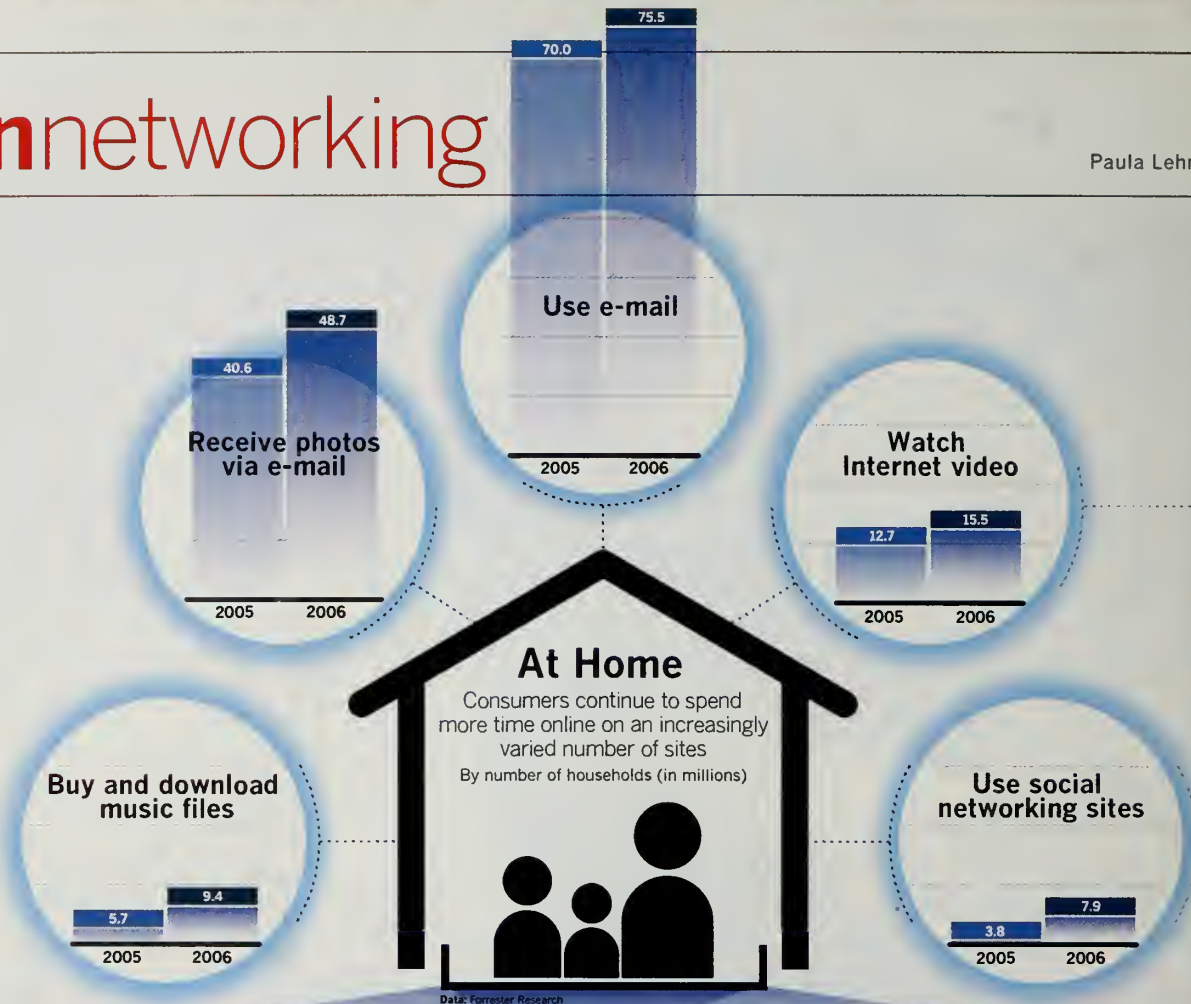
TEND: BUSINESS RESOURCES GO GREEN

More resources are available for ecologically conscious managers. GreenBiz.com offers articles and guidelines on how to create and measure the progress of green products and processes. And venture capital firm Kleiner Perkins Caulfield + Byers formed the Greentech Innovation Network, a group working to spur earth-friendly business innovation and partnerships.

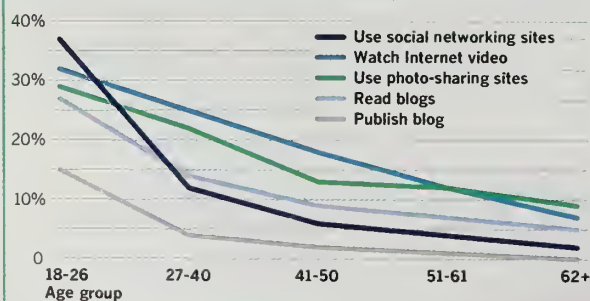


TOOL: DATA MINE

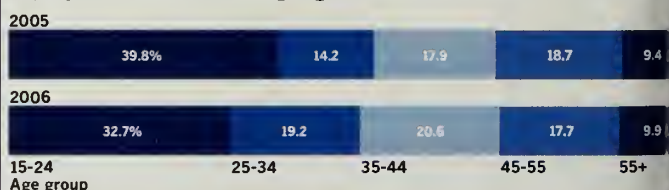
Data mining via Google can provide millions of hits, but the huge volume can take an enormous amount of time to screen. Accelovation is a software tool born in the MIT Media Lab that uses sophisticated linguistic algorithms to dissect texts. The software goes beyond keyword search to translate broad statements about innovation needs, analyze sentence structure of online content, and then match the two. It scans scholarly research, consumer blogs, product Web sites, or white papers, looking for emerging trends, new technologies, and fresh business models. It's already used by Procter & Gamble and 3M.



What people do online monthly

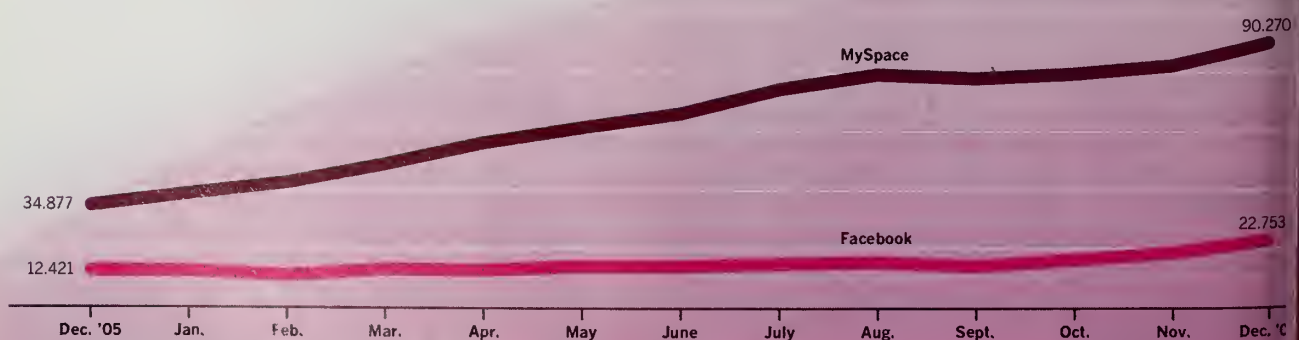


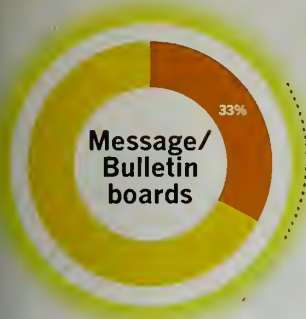
MySpace users are aging



The appeal of giant networks is leveling off

Unique Visitors (in millions)





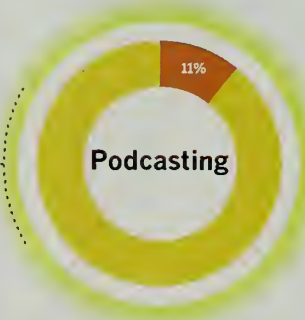
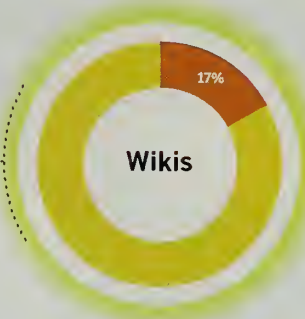
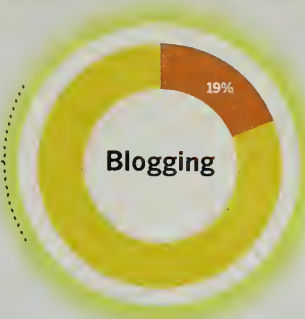
At Work

At the office, Web collaboration is flourishing. Companies are using social media to connect with customers, find talent, and develop products

Here are the social networking tools that matter most, and the percentage of companies that rely on them



Data: Nora Barnes, Eric Mattson
University of Massachusetts, Dartmouth



Strategy: Finding Talent

LinkedIn, a networking site for professionals, has many corporate fans

1 million professionals, 13,000 recruiters

90% of top-rated companies represented

1 million members (about 20%) are senior executives

10+ corporate subscriptions for staffing/recruiting departments. Annual subscriptions cost \$10,000 to \$250,000. Companies with corporate subscriptions include Microsoft, eBay, Target, Sony, Netflix, FedEx, L'Oréal, and Deloitte.

Best Practice: Generating Innovation

IBM's tactics

■ **Lotus Connections:** IBM offers software to its corporate customers that transforms internal and external communications into a social computing format. IBM has used social networking technologies internally since 2003.

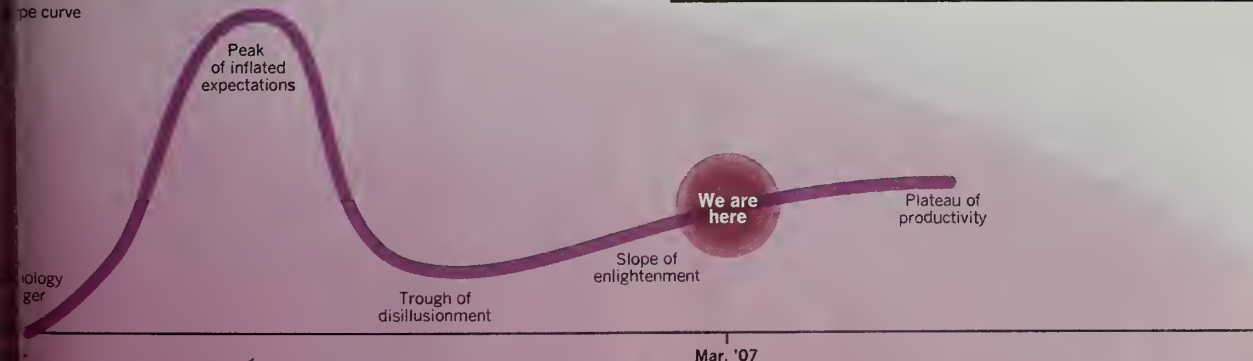
■ **Podcasts:** During its first six months of podcasting there were 72,000 downloads.

■ **Wikis and Blogs:** More than 20,000 IBM employees currently use wikis. 2,500 IBM employees publish internal blogs.

■ **InnovationJam:** In 2006 more than 150,000 members of the IBM family participated in an online brainstorming event. Over the course of the two 72-hour sessions, 46,000 ideas were posted online. IBM will invest \$100 million in the 10 best ideas.

But the value of networking tools is on the rise

type curve



Start your engines: The race is on to build a car that gets 100 mpg The purse? A \$25 million prize—and a piece of history

Prizers have long been used to stimulate innovation. In 1919 the Orteig Prize offered \$25,000 to the first pilot to fly the Atlantic nonstop. Charles Lindbergh won it in 1927, fostering the aviation industry. In 1996 the X PRIZE Foundation offered \$10 million to the first private team to fly into space. Burt Rutan and Paul Allen beat 25 teams from seven nations in 2004 to win by designing and launching the SpaceShipOne.

This spring the Automotive X PRIZE will offer \$25 million to anyone who can design and build a superefficient, commercially viable car that gets 100 miles per gallon. "Our intention," says Mark Goodstein, executive director of the contest, "is to wave a big red flag around this problem. The two main guideposts for us are breaking our addiction to oil and numbing the effects of climate change." According to the National Highway Traffic Safety Adminis-

tration, the average fuel economy for the current fleet of autos available to American consumers is no better than Ford's original Model T—around 25 mpg.

Shaping a competition to promote the privatization of space travel may prove easier than creating a contest for an innovative car. Determining equivalencies between possible future fuels, which would allow judges to compare the performance of a traditionally powered vehicle with another using a fuel cell, electricity, or other advanced technology, is complex. And it remains to be seen if major car-makers will buy into the challenge or ignore it. Neither Boeing nor Lockheed Martin participated in the original X PRIZE, though they worked on similar projects for NASA.

The hope is that the Automotive X PRIZE will goad the automakers into action. The best-selling Prius has

already turned Toyota into one of the most powerful green brands in the world. In January, General Motors took the wraps off its Chevrolet Volt concept car, which gets up to 150 mpg by combining electric-drive components with a small backup engine. However, GM says it needs big improvements in battery technology to bring the Volt to production. There are rumors Toyota might get close to the 100 mpg benchmark with the upcoming 2009 redesign of the Prius. Mercedes-Benz has toyed with ultraefficient aerodynamic prototypes that achieve fuel economy of more than 70 mpg, thanks to their shape.

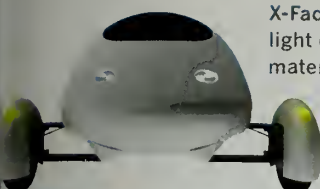
The prize could also fire the imaginations of grease monkeys and homegrown enthusiasts. Some hybrid owners have tinkered with their vehicles, adding components that double mileage to 100 mpg. Small startups are working on vehicles that could

win, too. In January, Accelerated Composites in Carlsbad, Calif., announced a two-seat vehicle, the Aptera, that will cost around \$20,000 and get an astonishing 330 mpg.

That is, perhaps, the best sign of the strength of the X PRIZES: the proliferation of technologies and projects already working toward the award's main objectives. On the Web site (<http://auto.xprize.org>) the contest is announced this way: "People love their cars. They are vital links to our jobs, our community, ourselves. For everything we love about them, cars are chained to the most severe global crises of our time: oil dependence and climate change." With 40% of world oil output fueling the automotive industry (transportation soaks up 65% of all U.S. oil consumption), the world needs a car that gets 100 mpg.

ACCELERATED COMPOSITES APTERA

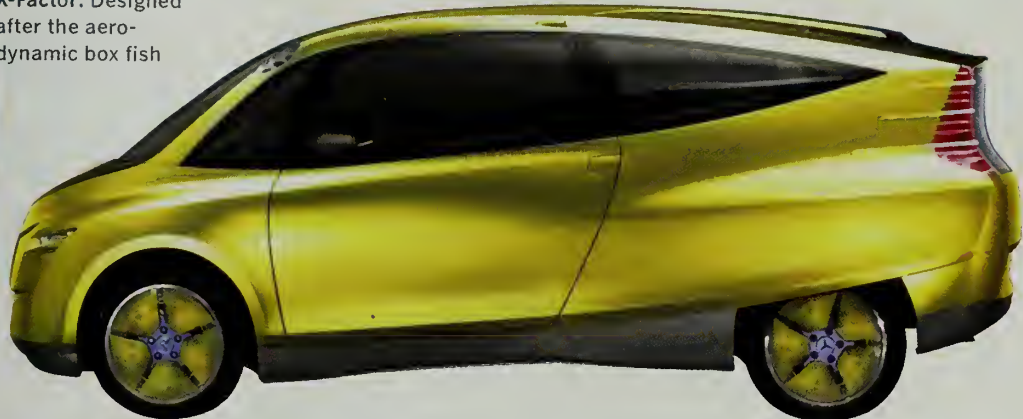
X-Factor: Ultra-light composite materials



MPG 130
0-60 11 SECONDS
HP 25
TOP SPEED 95 MPH

DAIMLERCHRYSLER'S BIONIC

X-Factor: Designed after the aerodynamic box fish



MPG 70
0-60 8.2 SECONDS
HP 140
TOP SPEED 118 MPH

CHEVROLET VOLT

X-Factor: Compatible with ethanol, gasoline, biodiesel or hydrogen



MPG 50
0-60 8 SECONDS
HP 160
TOP SPEED 120 MPH

insocial

HOW VENTURE PHILANTHROPISTS USE
DESIGN THINKING
TO HELP SOLVE
REAL-WORLD PROBLEMS

ACUMEN FOUNDER JACQUELINE NOVOGRATZ



FROM THE JOURNALS OF ACUMEN'S JACQUELINE NOVOGRATZ

APR. 6, 2006, DELHI, INDIA I've been thinking a lot about C.K. Prahalad and his theories on the bottom of the pyramid. He made a powerful contribution to the world in providing a new framework for thinking about the poor. At the same time, simply selling goods to the poor will not change poverty on a large scale. We must link not only consumption to the poor but also savings, investments, and income, for there are no other real ways to get at problems of poverty on a large-scale basis.

On the way back to the hotel, we sit in traffic in Delhi in front of the five-star hotels. Every day in cities across India, beggars approach cars. Sometimes there will be three or four at a single stoplight. A woman approaches us with a tiny baby attached to her withered breast. She just stands there with the child suckling...in the afternoon heat. I think of the philosopher from Princeton who claims that we would help someone if they were right in front of us, and I think even more of my friend

Jim, who is thinking of doing a film about Mother Teresa.

We've had long conversations about her and what compassion means, what it means to live a life of compassion. I do nothing to help the woman, just look her straight in the eye and say, "I'm sorry. I'm sorry." Right behind this woman is another and then another; after she sees in my eyes that I will not give her anything, she walks over to her friend and they start laughing... I know that begging in Bombay is a business with beggar-masters, hierarchies, assigned territories. Mother Teresa's contribution was in providing comfort to those she touched. Maybe even more so, the mark she left on the world was in the many whom she inspired to do more, be more. She also brought visibility to people the world didn't want to see. In our own way, that is what Acumen Fund is trying to do—by starting with trying to understand who poor people are and what their concerns are, and then building solutions from that perspective and not simply our own.

Y JESSI HEMPEL

Travel northeast out of New Delhi, and long after the paved roads have given way to dirt, you'll reach Thathia, a tiny village in Kannauj. Tucked away beside the sacred waters of the Ganges, it's an impoverished rural district in one of the poorest states in India, Uttar Pradesh. Less than 20% of people read. Infant mortality is 8.5%, nearly the highest in the country. Disease is rampant.

This is where Garima Devi runs her Drishtee Telekiosk, a humble office from which she offers Internet access and technical support. Villagers walk miles to get her help, according to Drishtee CEO Satyan Mishra. I need a loan because my sugarcane crop failed, someone will say. My husband has died and the government pension never came. My son lost his job; can he get computer training? Devi, who is 21, listens, then logs on to her computer and goes to work.

Devi is neither social worker nor missionary. She's an upwardly mobile career woman. Think of her kiosk as the digital Kinko's franchise. She owns the PC and the table it sits on. She charges 10 rupees to 25 rupees—about 20¢ to 50¢—per transaction, and keeps up to 65% of the profits. This lets her support her parents and her school-age little brother. By Kannauj standards, it's a good living. The remainder goes to Drishtee Dot Com, which, according to a recent Deloitte survey, is the fastest-growing high-tech startup in India. Drishtee, or "vision" in Hindi, is in turn financed by the Acumen Fund.

Billing itself as a nonprofit venture capital firm, the Acumen Fund uses the principles of design to solve the problems of the poor. Just as the Procter & Gambles and Motorolas of the corporate world conduct extensive ethnographic research on consumers, Acumen finances companies that create from the bottom up. Instead of shoppers at a Los Angeles mall, however, it begins with people in villages like those in Thathia. "Start with the individuals," says founder Jacqueline Novogratz. "Build systems from their perspective. Really pay attention, and then see if they can scale."

Under Novogratz's leadership, the New York-based fund

manages \$20 million in investments in companies that fall within three portfolios: health, water, and housing. It's not a lot of money compared with any of the traditional venture funds in Silicon Valley. But Acumen's goal is not to launch initial public offerings. Rather, Novogratz and her team are building prototypes for new business models that measure returns in social benefits as well as monetary rewards.

Novogratz has a gift for pulling together disparate people—financiers and aid workers, say—to come up with new ideas. A former banker who worked in Rwanda in her twenties, she writes in a journal nightly during her frequent trips to visit Acumen companies. She also jogs daily, and makes time to have coffee with everyone from Goldman Sachs partners to Kenyan health-care workers. “We’re creating an overall design for how you provide goods and services to poor people,” she says.

Observing customers to uncover their unmet needs, creating prototypes of new products and services for them, iterating and improving those until they work, looking for new business models—these are all the critical fundamentals of design that Acumen uses in its work. At a recent workshop given by Tim Brown, chief executive of the innovation consultancy IDEO, these same principles of design thinking were inculcated in eight Acumen Fellows, the young professionals the venture fund sponsors to work with its companies in Africa and Asia.

It's also an approach to alleviating poverty that is winning favor among business and political leaders.

Novogratz has built an extensive global network of counselors, donors, and well-wishers. Acumen counts among its advisers Tae Yoo, the head of philanthropy at Cisco Systems, Louis Boorstin of the Bill & Melinda Gates Foundation, former U.S. Senator Bill Bradley (D-N.J.), marketing maven Seth Godin, Chris Anderson, chairman of TED Conferences, and IDEO's Brown. Major donors include Google and the Bill & Melinda Gates Foundation.

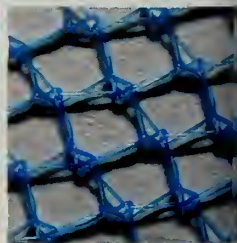
Lack of money is no longer the major hindrance to solving many of the world's most vexing social problems. Philanthropists such as Gates, Warren Buffett, Richard Branson, and Joan Kroc now make gifts in the billions. Charitable giving in the U.S. has jumped 23% in the past four years.

Rather, there's a paucity of creative ideas. “It's all about innovation,” says Brown. He explains that using the methodology of design can solve social, as well as business, problems. “We're pretty good at taking a bunch of disparate components and figuring out the solution,” he says.

By working closely with Acumen entrepreneurs, donors, corporate partners, and governments, Novogratz and her team are creating a laboratory to design new business models and funding mechanisms. Much of the philosophy is drawn from the University of Michigan's Ross School of Business economics professor C.K. Prahalad, whose bottom-of-the-pyramid theory holds that there's great untapped market potential among the 4 billion people who make less than \$2 a day. Novogratz travels frequently to India and Africa to spend time in the communities she serves. She

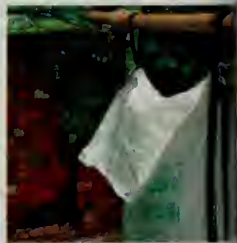
HEALTH

More than 1 million people a year die from malaria in Africa. A to Z Textile Mills of Tanzania makes bed nets carrying long-lasting insecticide. It employs 2,000 people and has sold more than 5 million nets.



WATER

For many of India's 325 million people living in poverty, water is scarce. IDE India makes a \$30 drip irrigation kit and teaches farmers how to use it with a Bollywood-style film. It has sold more than 85,000 kits.



HOUSING

Three in 10 Pakistanis live in squatter camps. Saiban is creating a \$50 million private mortgage market. It's financing 369 families and plans with Acumen to back 6,456 more in a planned community.



and her staff search for promising business models like Drishtee's. They draw from philanthropic and business resources to help them grow. And they partner closely with social entrepreneurs like Mishra.

Acumen eschews giving money away. Instead, the fund leverages its charitable dollars through equity and debt. Its donors are labeled "investors." They receive semi-annual statements tracking the social and financial progress of portfolio companies. Acumen has brought in \$667,000 in payments and interest to date. It made \$600,000 investment in WaterHealth International to help the startup expand its franchise model for delivering safe, affordable water to Indian customers. It's beating Pakistan's first home ownership market for the poor by putting up \$1.25 billion to generate a \$3.75 million guarantee by OPIC, Washington's Overseas Private Investment Corp. That money will release \$50 million in mortgages from the National Bank of Pakistan. Acumen's most successful company so far is A to Z Textile Mills, a Tanzanian family-owned maker of mosquito nets to protect people from malaria-carrying insects. The nets currently safeguard more than 5 million people in the country, and production is ramping up to 7 million annually. A typical

APR. 5, 2006, DELHI, INDIA Satyan is a real-deal entrepreneur. [Internet kiosk company] Drishtee is his life. It is all he thinks about, he can discuss it all day long, and he is going to make it work. Satyan is neither shy nor recalcitrant. He is a man on a mission. In the past year, he has learned a great deal about how best to roll out the product. The problem with too many rollout schemes, he tells us, is that they are top-down and not focused on customer needs. Consequently, Drishtee is establishing a new product-services company called Quiver, which will focus on the design, development, and delivery of services that will be layered onto the Drishtee platform. As part of Satyan's commitment to Quiver and to a customer-centered approach to service delivery in rural India, he is moving to his own village for three months, where he will live among villagers and mostly listen to them, to what they need, what they will pay for, what they aspire to, and who they want to be.

His current rollout scheme is inspired by knowing who people are. Drishtee goes into a community where it has residents sell Drishtee services for a specified period of time. The top salesperson is offered the opportunity to purchase a franchise given that he or she not only has proven marketing skills and understanding of the product, but also hungers [to use them]—and he or she comes with an initial customer base....

I ask Satyan for a profile of the kiosk operators. He says they have two common qualities. First, they really know the communities and are respected by people there. This is key to the enterprise's success. Second, they have fire in their bellies and will do what it takes to succeed. His challenge? To work with more women franchisees and poor people, for both groups are the hungriest. According to Satyan, women also are more likely than men to open the kiosks early and keep them open later. The problem is that women are typically undocumented and can't get loans.

charity would have had to invest \$390,000 in grant money and management costs to finance the factory, without reaping any real return. Acumen experimented with lending the money to A to Z instead. Last fall the company made its final payment on a \$325,000 loan at a 6% annual interest rate, delivering \$422,500 back to Acumen. The investment cost the fund \$130,000 over five years to manage, for a net loss of \$32,500. Considering the 2,000 jobs that Acumen helped



APR. 13, 2006, LAHORE, PAKISTAN Still, the work is hard. It can take a year for Kashf [an Acumen-sponsored microfinance institution] just to get its feet wet when moving into a new area or village. For the poor, borrowing is a particularly risky proposition—and so any organization needs to take time to build trust and help people understand the risks they are taking. Some communities initially fear that Kashf will kidnap their daughters. Communities also don't repay at first, testing whether Kashf is more a charity or a bank. We ask Sadaffe [Abid, Kashf CEO] how Kashf handles this. "We tell them that we'll just wait for the repayment. Sometimes we just sit with them, even up until 10 or 11 o'clock at night, and finally, always, they end up finding the money. And then they know."

Regarding Islamic lending practices, Kashf structures repayments with fees and interest computed into the biweekly payments. They tell the women that there is no interest but a service cost added to every

loan. Over time in every village, women come to understand, and to accept, the 20% "service charge," as it is so much lower than what the local moneylenders would charge....

This work inevitably is about changing behavior and long-entrenched patterns. It is about coming into communities, often as outsiders, and asking people to take risks when the upside is not always immediately apparent. Offering a 20% loan as opposed to a 300% one or selling a \$15 drip irrigation system that can quadruple income levels sounds like a no-brainer, but it is anything but that. It means asking people to change what they know, to go out on a limb.

Suffering comes from what we lose, and the prospect of loss is especially frightening when you have everything to lose. We have to get better at understanding the arc of building businesses for the poor—how long and how expensive R&D and prototyping stages are, what typical marketing costs are, and what it takes to get people to be first movers.

offices recently have moved to a floor in Google's New York building.

Drishtee founder Satyan Mishra is a typical recipient of Acumen financing. A soft-spoken 33 year-old, he is as passionate when he describes his tech startup to his parents' neighbors in their small Indian village as he is when selling an audience on his vision at the Clinton Global Initiative, a program that convenes global leaders in New York to discuss social problems. Traditionally, welfare agencies and philanthropies have looked on the poor as burdensome, requiring expensive social services and government handouts. Mishra, by contrast, sees potential customers. After getting his MBA from the Delhi School of Economics, he ran a software-development outfit called Cyber Edge that gave the city of Bhopal

create at the factory, paying better-than-average local wages, this was indeed a tiny loss.

Novogratz has mapped out a vision to reach \$100 million under management over the next five years through a combination of increasing profits and attracting new donors. Google has given Acumen \$5 million to fund its fellows program, and the company's engineers are building a system to track its investments. The fund's

access to the Net. "I wanted to earn a living, yes," Mishra said recently while visiting *BusinessWeek's* New York offices. "But it wasn't enough. I needed to do something that would make a real difference." In 2000, government officials asked him to help bring those services to villages, and he saw an opportunity for both financial and social rewards.

In classic design form, Mishra began with an unmet need: In 638,000 rural Indian villages, there was little



essential, the

POLICE

2

access to information about health, pensions, and government resources. Could he devise a service that was seamless yet affordable? Mishra tried several prototypes to come up with an information kiosk, a hub housing a PC, modem, digital camera, and fax machine.

To roll out the kiosks, he launched a contest. Villagers competed to sign up the highest number of new clients. Mishra offered franchise opportunities to the winners, making them owners, not employees.

By 2006, Mishra had 1,000 kiosks up-and-running, but he needed more resources to increase the number of kiosks and provide new services, such as connecting villagers with lenders for small loans or linking them with health-care providers. Enter Acumen, which made a \$1 million equity investment in 2006. In 2007, Acumen will lend an additional \$600,000 for new kiosks. Drishtee is now opening four daily and will expand to 10,000 in two years.

Novogratz combines a business pedigree with experience in philanthropy. The oldest of seven children in a close-knit family, she worked her way through the University of Virginia and then took a job with Chase Manhattan Bank. In her mid-20s, she left Chase to go to Rwanda, where she worked with local women to start a bakery. (Returning later after the 1994 massacres there, she found only a patch of green paint where the bakery had once stood.)

Back home, Novogratz earned an MBA from Stanford University in 1991 and then landed at the Rockefeller Foundation. There she launched the Philanthropy Workshop,

a program to teach the wealthy how to put their charitable dollars to good use. In the mid-1990s, she spent two years distributing more than \$100 million in New York City on behalf of an anonymous donor. It was hard to find initiatives that made a real impact. That inspired her to start a nonprofit that would use design to shape new kinds of programs and capital markets to finance them. With seed money and advice from several prominent philanthropists as well as the Rockefeller Foundation and Cisco Systems, she started Acumen.

The fund's most crucial contribution to young companies isn't capital. It's the staff's ability to see old problems with fresh eyes. Drishtee has used this skill to great advantage. Last April, Novogratz paid a visit to the company's office near Delhi. She sat down and asked Mishra: "Where do you need help?" "It's the women," he replied. "They make better kiosk owners because they open earlier and stay open longer." But many banks in India don't lend to women.

On returning to the U.S., Novogratz made a call to the Nike Foundation to talk to director Maria Eitel. Acumen immediately received a \$250,000 grant. It gave \$50,000 to Drishtee to train village women in basic business skills, and is negotiating with an Indian bank to use the remaining \$200,000 as a one-to-five guarantee toward \$1 million in loans. "We said: 'Look, we'll take the first 20% of your risk, because we want to prove to you over the next three years that women are indeed bankable income,'" says Novogratz.

That's an example of the inventive way Novogratz puts the fund's money to work. It's smart design. **IN**

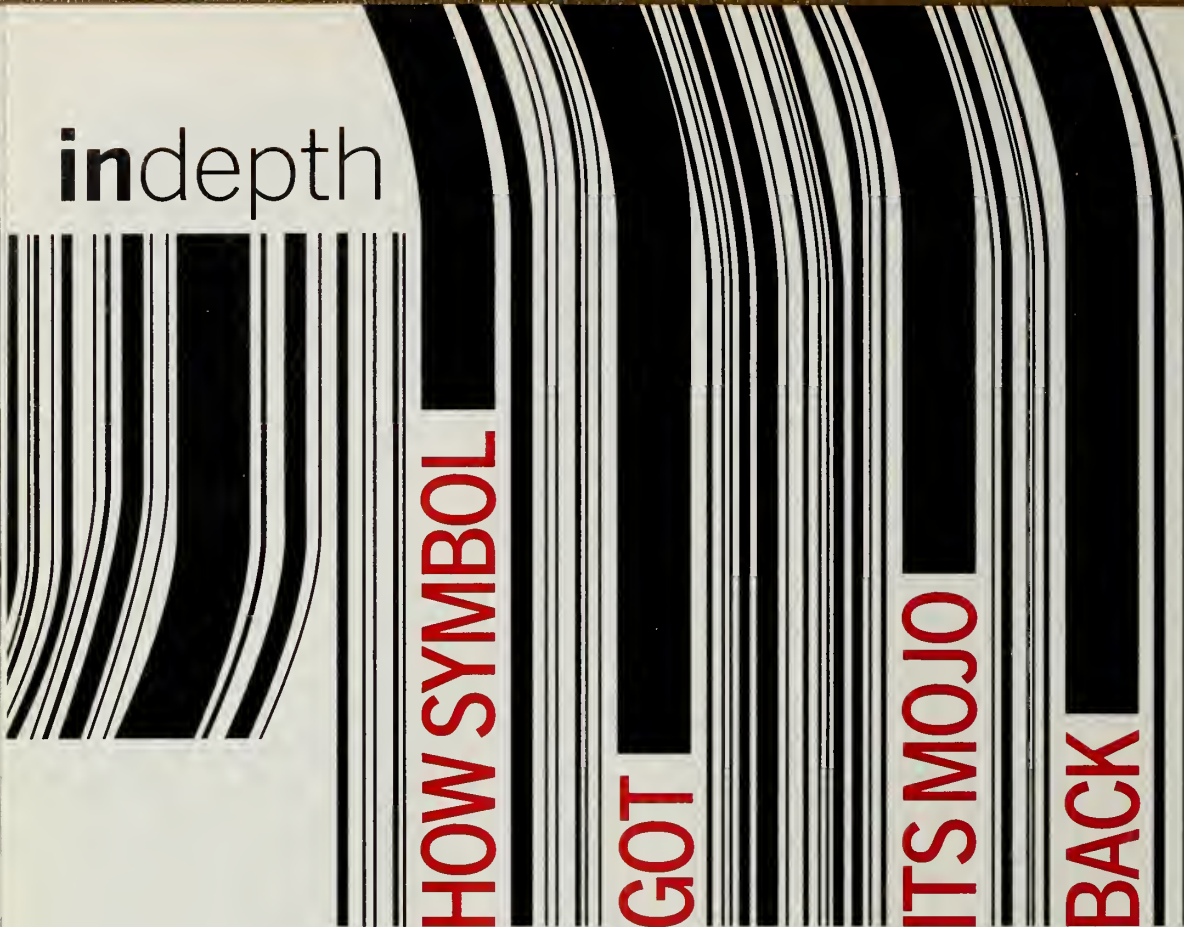
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It is what makes bullet-resistant vests and saving
police officers possible. It is chemistry.

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HOW SYMBOL

GOT

ITS MOJO

BACK

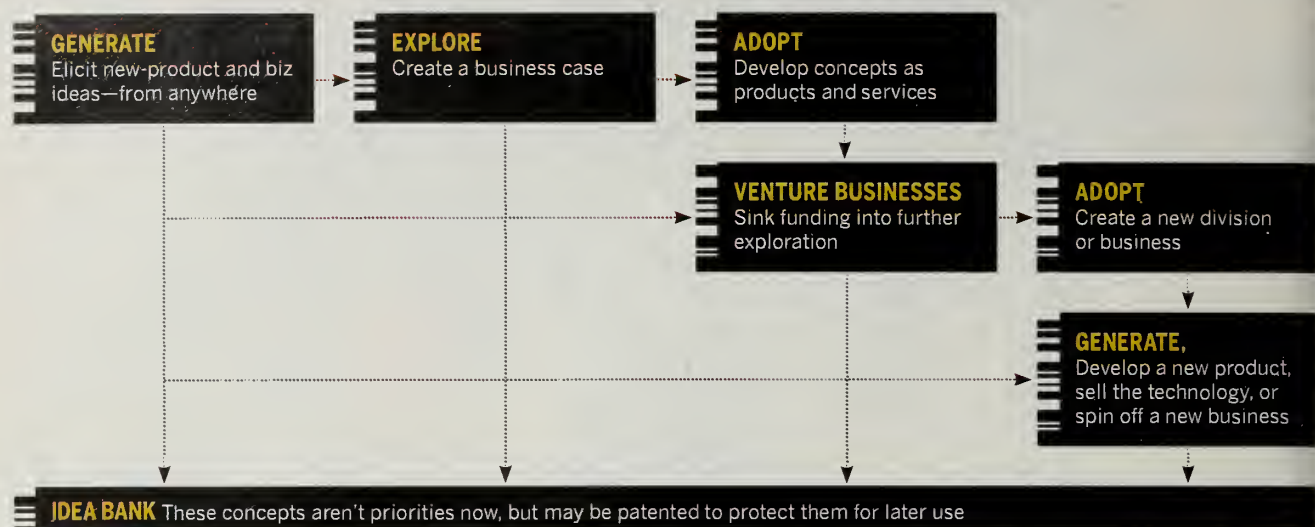
| BY JESSI HEMPEL

Symbol Technologies was a nifty little high-tech company. It created the very first bar code scanner in 1980 and kept pace with the rapid growth of its customers—FedEx, Wal-Mart, Home Depot, and the U.S. Postal Service. At each step of the way, the Holtsville (N.Y.) company was there with a steady series of original products to track its customers' growing flow of goods around the world: portable scanners, handheld computers, voice technology, and radio frequency identification (RFID). For two decades, Symbol was a paragon of innovation. Its creative engineers consistently developed new tools for an important client base.

Then it all came to an end. The Symbol story is a complex tale of corruption and mismanagement, rescue and recovery. It involves an ex-CEO who is on the lam in Europe, a former Cisco Systems executive brought in to patch the company back together with Six Sigma glue, and a Wall Street guy who tried to inject risk back into a culture that had leached it out.



CREATING YOUR IDEA STREAM



Most of all, the Symbol story is about the fragility of innovation and how easily it can be lost, even with the best of intentions. And it shows how herculean efforts to revive a company can pay off. On Jan. 9, Motorola completed a \$3.9 billion purchase of Symbol, its second-largest acquisition ever. Last September when the deal was announced, Motorola Chairman and Chief Executive Ed Zander extolled Symbol's strong product, patent base, and creative engineers. He said he plans to leave the research and development department mostly intact as a Motorola division. And he insisted that Symbol's top 15 executives, including CEO Salvatore Iannuzzi, stay on for at least two years. The electronics giant will likely pour resources into Symbol innovations. Combining the smaller company's RFID technology with Motorola's wireless capabilities holds promise. As Motorola Chief Technology Officer Padmasree Warrior put it, Symbol has a culture that encourages "intrapreneurial innovation and early-stage business development."

This is how Symbol lost its mojo—and how it's trying to get it back.

SCANDAL In May, 2001, the Securities & Exchange Commission began investigating Symbol after receiving an anonymous letter alleging that some insiders were inflating sales. Top executives at the Long Island company eventually admitted to overstating revenue by \$234 million and net income

by \$325 million from 1998 to 2004. By the investigation's close in 2004, most of Symbol's top managers were ousted, eight were indicted on various charges, and the company had to pay a \$138 million settlement. The face of former CEO Tomo Razmilovic still adorns wanted posters; according to *Newsday*, he lives in exile in a seaside chalet in Bussevik, Sweden, having fled the country in 2002.

The scandal devastated Symbol. But in its efforts to restrain the freewheeling culture that led to creative accounting, the company severely tamped down the inventive spirit that drove creative ideas. To return order, its directors hired William Nuti away from Cisco, where he was a senior vice-president. Nuti was named CEO in December, 2003, the fourth in four years to occupy the top job at Symbol's sprawling, three-story headquarters. Nuti moved fast to bring order, discipline, and profitability to the workforce of 5,600 and to restore investor confidence. He replaced 15 of Symbol's top 16 executives—many of the recruits were trained in Six Sigma management methods and came from Cisco. He reined in headquarters and the four other corporate offices around the globe with stringent reporting requirements, constant meetings, and rigorous personal oversight. And he layered onto the once-entrepreneurial organization a powerful management system that emphasized predictability, reliability, and measurement.

Under Nuti, innovation became a much more controlled process. The R&D team led by the Three On's—on spec, on time, and on budget. He built a best-in-class product lifecycle management (PLM) system to make product development as efficient as possible. He pushed scientists, engineers, and designers to focus on the product areas that had a good chance for success and an immediate impact on quarterly financial results. "We needed incremental innovation" to drive higher margins, said Nuti, who describes the system he inherited as wasteful and unfocused. "We needed a more disciplined approach in deciding how we were going to spend our money on true R&D vs. product improvements."

Symbol's new metric systems were designed to foster short-term profitability. That may have been what was required, but there was a price to pay. The metrics were excellent for collecting and analyzing data around existing markets, but emerging markets provide the guarantee of a potential return on investment. In its push to meet short-term financial targets, the company cut back investments in riskier, longer-term projects. By 2005, Symbol had few new ideas left in its pipeline. "It was nearly empty," said Alistair Hamilton, vice-president for innovation and design. In the name of efficiency, Nuti had cut investment in R&D as a percentage of total revenue from 14.4% in 2003 to 8.8% in 2005. At the same time, general and administrative expenses had risen to 30.5% from 28.4%.

At first, the new CEO's efforts paid off. By the end of the fourth quarter of 2004, quarterly earnings had jumped to \$28.5 million from \$5.2 million in 2003. But the Six Sigma effort to tighten efficiencies ran out of steam. Symbol's stock fell 40% between February and August, 2005, as investors lost patience. Jim Cramer spouted on TV: "I feel let down. Your stock is at 10. Tell me why I shouldn't jump out the window because of what's going on with Symbol Tech?" In August, 2005, after a dismal quarter in which the company lost \$30.5 million, Nuti left to take the top position at NCR.

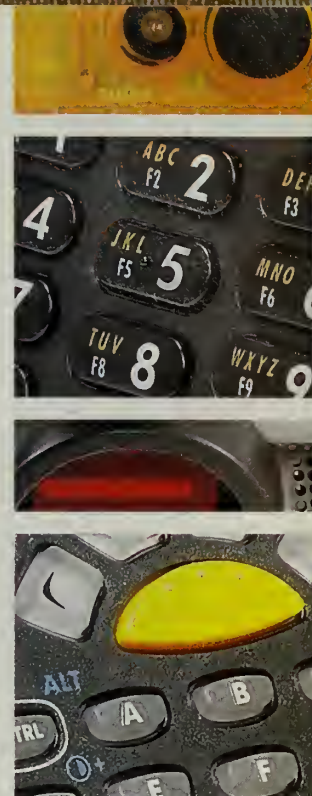
Symbol's eight directors replaced him with Iannuzzi, a fellow board member with 30 years of experience on Wall Street at KPMG, Bear Stearns, Bankers Trust, and CIBC. With a background in auditing, regulation, and administration, Iannuzzi could help Symbol

continue to bounce back from the legacy of its scandals, but he also had a high tolerance for risk. And he understood the company's DNA. "Our customers don't just look for products from us," he said. "They look for new ideas to make their business more profitable. If I don't encourage innovation, I'm cheating not only our customers but our investors."

Just days after Iannuzzi moved into the corner office, Motorola CEO Zander approached Symbol to begin conversations. The smaller company's wireless business offered the electronics giant a missing piece. But even as the two negotiated, Iannuzzi needed to shape up Symbol. He quickly moved to restore the R&D budget while slashing the overall budget, cutting 532 jobs, or 10% of the workforce, to wrestle costs under control (before he left, Nuti had begun the cutbacks). Iannuzzi then convened a council of a dozen Symbol "priests." These were people who understood the culture and the need for new ideas and opportunities—senior managers, longtime employees, prodigious producers of its most promising patents.

The 27-year-old high-tech company needed to restock its innovation pipeline. The priests divided the pipeline into three categories. The first is low-risk and focuses on incremental changes that make existing products better. Think ergonomically weighted handles for scanners. The second embraces risky ideas that have a decent chance of being realized. These new concepts don't have a market yet, but they could within two to five years. What if a new technology allowed scanners to play videos for customers? The riskiest category involves possible breakthroughs so radical they could disrupt existing Symbol businesses. These ideas are so off the map that internal divisions might not see them coming. Even if they did, chances are they would not invest in threats to their current work. Nuti had focused on low-risk changes that could translate into short-term profits. Symbol needed to manage a higher-risk pipeline.

In October, 2005, Iannuzzi appointed two innovation champions: Vice-President Hamilton and Chief Technology Officer Ray Martino. Both were seasoned Symbol managers. Hamilton had put in nine years, Martino more than 20. Hamilton looked the part of the classic designer, sporting black suede tennies, a sports jacket, and a mischievous smile. Martino had the mono-



In a push for profits, Symbol cut back on R&D—and was left with few ideas in its product pipeline



Symbol's two new innovation champions won a pledge from the board to back riskier ideas

chrome shirt and pensive, focused stare of an engineer. Together, they embody innovation's most critical element, balance. "It's all about the yin and the yang," explained Martino with a slight chuckle, shifting his weight as he sat in a white Eames chair in Symbol's design lab.

The two are product design masters. But their challenge was to design a stronger innovation pipeline. They needed to develop a disciplined procedure for spurring big-impact ideas. This meant aligning their colleagues, managers, and those they managed behind a new push for innovation. As with any iterative process, they made some key findings.

COMMUNICATION IS CRITICAL Martino and Hamilton spent weeks toting their PowerPoint display from conference room to office to the high-backed booths of nearby restaurants, sitting down with more than 100 vice-presidents and senior managers. They explained that Symbol had become well-run—perhaps too well-run. Under Nuti, the company was encouraged to develop products with the best potential return on investment, but how do you measure ROI for products your customers haven't even imagined? Symbol, they argued, needed to focus as much on developing future opportunities as on executing successes.

Hamilton and Martino also set benchmarks for Symbol against other innovation-oriented companies such as Procter & Gamble and Apple. They looked at how venture capital firms managed their risk portfolios. And the two studied IBM's emerging-business opportunities strategy. That is an independent unit where Big Blue identifies and finances high-risk ideas with the potential to grow into billion-dollar business opportunities within five to seven years.

LEADERSHIP MATTERS On a crisp morning in February, 2006, Iannuzzi addressed the Symbol directors from the center of the boardroom's C-shaped cedar table. He explained how critical innovation was to the company's future, as Hamilton remembers it, and then passed the microphone to Hamilton and Martino. They argued Symbol should invest significantly more in higher-risk undertakings. They wanted to begin with a commitment to spend no less than 6% of overall revenues. The board gave its approval.

MANAGEMENT MUST BE BALANCED Hamilton and Martino focused on balancing risk-taking between centralized corporate and decentralized division management. "We wanted divisions in the company to control their own destiny," said Hamilton. "But left alone, they will silo themselves and solve their own problems." So in each division they named an advanced-development leader, or AD, who would push people to take more risk in incubating ideas and meet quarterly to monitor investment spending levels.

To finance the riskiest ideas that couldn't be developed within the business divisions, the two borrowed from IBM and set up a separate venture capital process. Symbol's Emerging Business Office (EBO) operates like the VCs on Sand Hill Road in Palo Alto, Calif. It is managed directly by Hamilton and Martino and has its own tracking system that will ruthlessly kill ideas that can't work. The EBO plans to spin off new businesses or integrate them into existing divisions. "We want to encourage people to cannibalize the business," Martino said. "Because if we don't do it, our competition will."

IDEAS ARE THE EASY PART Hamilton and Martino experimented with the new innovation process in the 100-person division that handles traditional scanners. There was no shortage of new ideas, they found right off, but most weren't usable. Some suggestions turned up in the form of paragraph-long sketches. Others had already become lengthy business plans. Most were still half-baked. "What we found out was that these new ideas required a lot of contact and advocacy from other people to work," said Hamilton.

AD leaders were told to connect people with fresh ideas to others across disciplines who could act on them. The pair also refined the electronic suggestion box to focus the information they were getting from colleagues to better evaluate an idea.

MAKE RULES, BREAK RULES Last fall, the two began to test the program in other divisions. It proved much slower going than they had hoped. Originally, they organized their emerging pipeline according to a tight quarterly timeline in which ideas were submitted during month one, reviewed during month two, and evaluated during month three.

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BALANCING YOUR RISK PORTFOLIO

LOW **PRODUCT DEVELOPMENT:** THIS INCLUDES LOGICAL TECHNICAL AND PRODUCT EVOLUTION LIKE IMPROVING THE KEYBOARDS ON HANDHELD COMPUTERS.

MEDIUM **CONCEPT DEVELOPMENT:** THESE IDEAS ARE AT LEAST TWO YEARS AWAY FROM DEVELOPMENT. FIRST, SIGNIFICANT TECHNICAL AND BUSINESS RISKS NEED TO BE EXPLORED.

HIGH **WILD IDEAS:** POSSIBLE BREAKTHROUGHS RADICAL ENOUGH TO DISRUPT EXISTING BUSINESSES. CONCEPTS SO OFF THE MAP THAT INTERNAL DIVISIONS MIGHT NOT SEE THEM COMING.

“Halfway through our beta [test] we realized, no, it’s not a quantified process,” said Hamilton. They stopped.

A year and a half into their initiative, Symbol’s once-empty pipeline is beginning to fill. Hamilton and Martino report hundreds of ideas are being generated. As many as 90% have been killed, but the remainder—several dozen in the medium-risk category and two considered the highest risk—have moved along to an exploration phase where designers and engineers are hammering out prototypes and business models. And on the first floor of a building in Symbol’s office park, the white board in Hamilton’s office is covered with the chicken-scratch sketches made by employees who’ve heard what he’s up to and poked in their heads with a quick, “Hey, do you have a minute? Because I have an idea...”

It’s too early to say whether Symbol will now begin to deliver the products that will maintain its lead in shaping the future of the

industry. New proposals are at least three years away from reaching customers. But early indicators are hopeful. The company was back in the black by the second quarter of 2006, announcing \$27.5 million in profits on \$453.3 million in sales just before the Motorola acquisition was announced. And this January, as Hamilton and Martino ordered fresh business cards emblazoned with the twin-peaked “M” of their new corporate logo, they continued to expand their efforts to new divisions.

The current chapter of Symbol’s saga is bright one. In its drive for innovation, the company has struck a promising balance between rigor and risk. So far, the seasoned survivor and Motorola appear to be in cultural synch. “Symbol’s sustained innovation history and breakthrough processes are strikingly aligned with Motorola’s,” says Chief Technology Officer Warrior. With Motorola’s money and backing, Iannuzzi says he can now turn more of those drawboard projects into products. **IN**

Who puts more fuel efficiency on the road and fewer pollutants in the sky? We do.



Innovations from Siemens can be found everywhere. Including the open road. Siemens is dedicated to providing highly efficient and cost-effective solutions for the development of alternative fuel technologies and design of hybrid vehicles. And our innovations are designed to minimize their impact on the environment. At Siemens, we're driving the industry toward a brighter, safer tomorrow.

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Bank of America Tower:

The world's greenest skyscraper, set to open early next year, is rising near Times Square. The \$1.3 billion building will be New York's second-tallest

| BY ADAM ASTON ILLUSTRATION BY JESSE JENSEN / A BRAND ABOVE

1

WATER FROM SKY & EARTH Not a drop of rain that falls on BoA Tower is sent down the drain. Rather, it's collected, routed to flush toilets, used to irrigate the green roof, and to run the air conditioning (AC) system. The tower also harvests water from condensation that drips from AC systems, which in turn are cooled by groundwater that seeps in from the bedrock before being added to the rainwater tank. All this promises to save enough fresh water to supply 125 homes per year.

2

DAYLIGHT SAVINGS Sunlight helps students learn and workers focus. It will also help cut BoA Tower's lighting energy needs by 25%. Floor-to-ceiling windows, 9.5 feet tall, are made of low iron glass manufactured by PPG Industries and assembled by Permasteelisa. This lets in more visible light than normal glass, yet still insulates well. Inside, sensors control ceiling lights, turning them down when daylight is plentiful or rooms are empty.

3

CHILL FACTOR Heat rises. That simple force lets BoA Tower virtually do away with costly, overhead chilled-air ducts and fans. Instead, cool air is pumped into a void under raised floors. As it warms, the air rises to ceiling vents, pulling more



compounds that can cause illness. Oxygen sensors trigger injections of fresh air into crowded spaces to help prevent "meeting room coma." When the used air is vented from the building, it's still cleaner than the outside atmosphere.

5

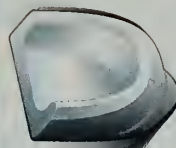
HOMEMADE JUICE A superefficient power plant, running on clean-burning natural gas, nearly trebles the tower's overall energy efficiency. By reusing waste heat and eliminating losses caused when electricity is shipped via power lines over long distances, the turbine meets four-fifths of the tower's peak needs. The setup wastes just 23% of the energy from the fuel source, far better than the 70% lost at a conventional grid-connected building.

6

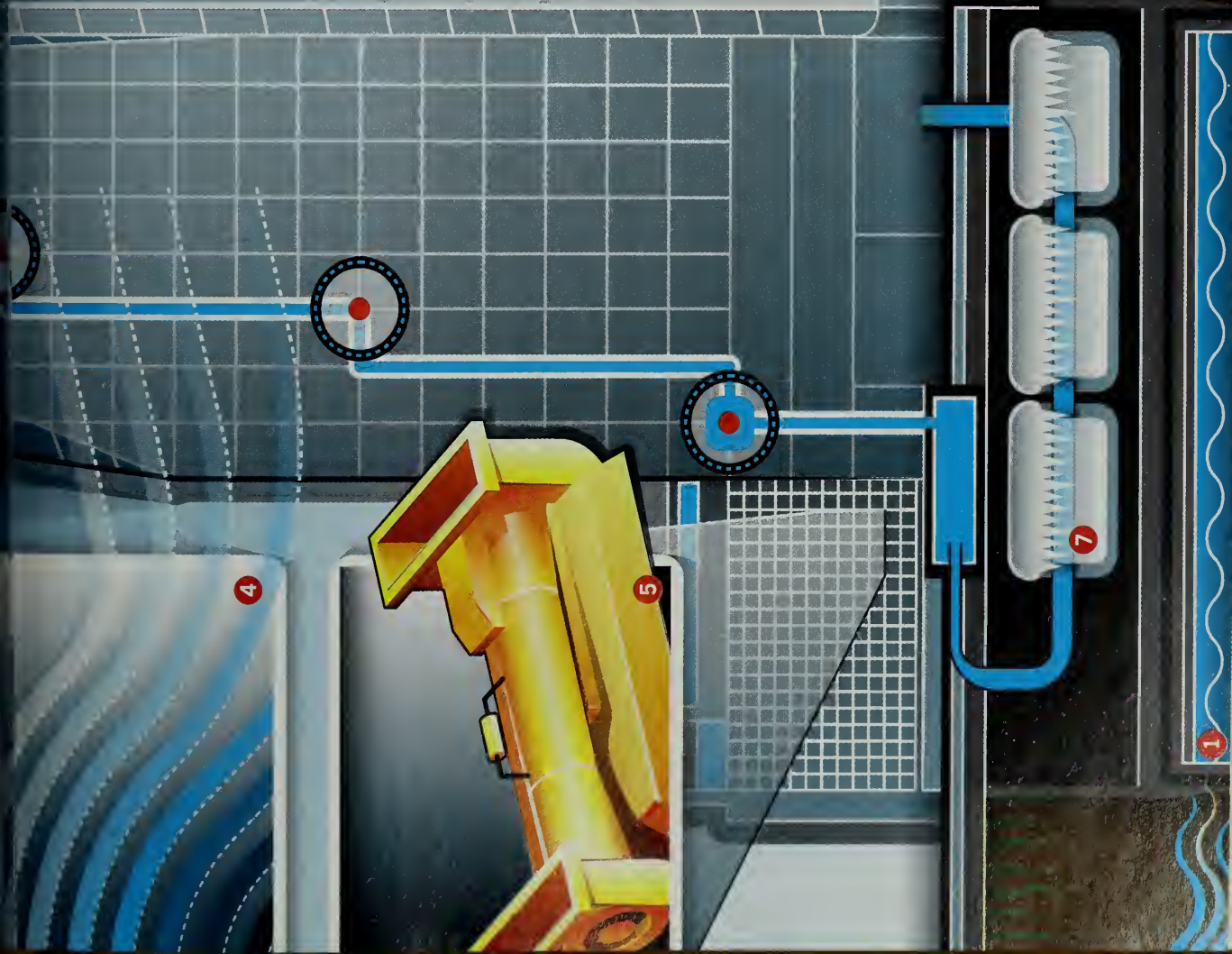
NO PARKING? In gridlocked New York, a project this big would normally have hundreds of basement parking spots. BoA Tower has practically none. Instead, the tower enhances midtown's network of public transport. New pedestrian tunnels connect the tower to 17 subway lines and commuter rail. With secure bike storage and shower access, bicycling is an option, too. And if a car is a must, BoA uses OZocar, New York's first hybrid-only fleet of liveries.

7

ICE STORAGE The 21st century's most advanced skyscraper takes a lesson from Victorian-era ice houses that collected lake ice in winter to use in summer. In the tower's basement, 44 squat cylindrical ice tanks will make ice at night, when power is cheaper, to help cool the AC system during the day. The trick cuts by 50% the energy needed to run the tower's AC on the hottest days, enough savings to pay for itself in three to five years. Made by CALMAC Manufacturing, the ice promises to cut pollution, too. When demand for power spikes on hot summer days, utilities fire up their least efficient, most polluting plants. BoA Tower won't need to tap much of this dirty power.



WATERLESS URINALS For male tenants, at least, the tower's most noticeable water-saving trick may be Falcon Waterfree's flushless urinals. Made of an anti-bacterial, superslick material, these fixtures will save 3 million gallons of water a year. They funnel urine into a tank filled with a liquid that floats on top, like oil on water. Urine settles to the bottom and drains out to sewers.



Case Study: GE

Students dream of user-friendly health care for Africans

1 The Akuaba radio bracelet would allow instant communication among patient, midwife, and clinics

2 A field microscope would analyze water for parasites, and shoot out a red flag that doubles as a larva trap

3 A fetal ultrasound belt with built-in sensors would reduce the training required for technicians

4 A flower-like dispenser would allow villagers to choose a dye for insect repellent in their mosquito netting

5 A noninvasive scanner would detect malaria by looking through the skin of a patient's hand

THE PROBLEM

GE Healthcare sells \$15 billion a year worth of big X-ray machines, CAT scans, and ultrasound testing equipment. The health-care division of General Electric usually differentiates its products by getting better and faster readings from its instruments—"feeds and speeds," as Lou Lenzi, the general manager of global design at GE Healthcare, puts it.

But to compete today, GE needs to focus on the human side of the equation, from ergonomics to emotions. And it needs to do that for cultures all around the world. For insight and inspiration, GE Healthcare recently turned to the undergraduate students of the Art Center College of Design in Pasadena, Calif., one of the world's top design schools. Consumer-product companies have long sponsored classes at Art Center, but this marked the first time GE Healthcare turned to students for ideas.

THE RESEARCH

Art Center fielded three teams of eight students. GE Healthcare asked them to address the challenge of expanding health care into rural Africa in 2016. The teams were composed of students majoring in design, transportation, and the environment. All spent the fall semester on the project, and on Dec. 7, Art Center's "Super Thursday," they joined other students sponsored by BMW, Honda, and Nestlé to present their designs.

THE PROTOTYPES

An ultrasound device would wrap like a blanket around a woman's belly. The design would reduce the training required for technicians. Current machines depend on a skilled

technician to guide a probe over the abdomen. The multiple imaging sensors woven into the blanket mean it would simply have to be correctly placed, a big advantage in countries where technicians are in short supply.

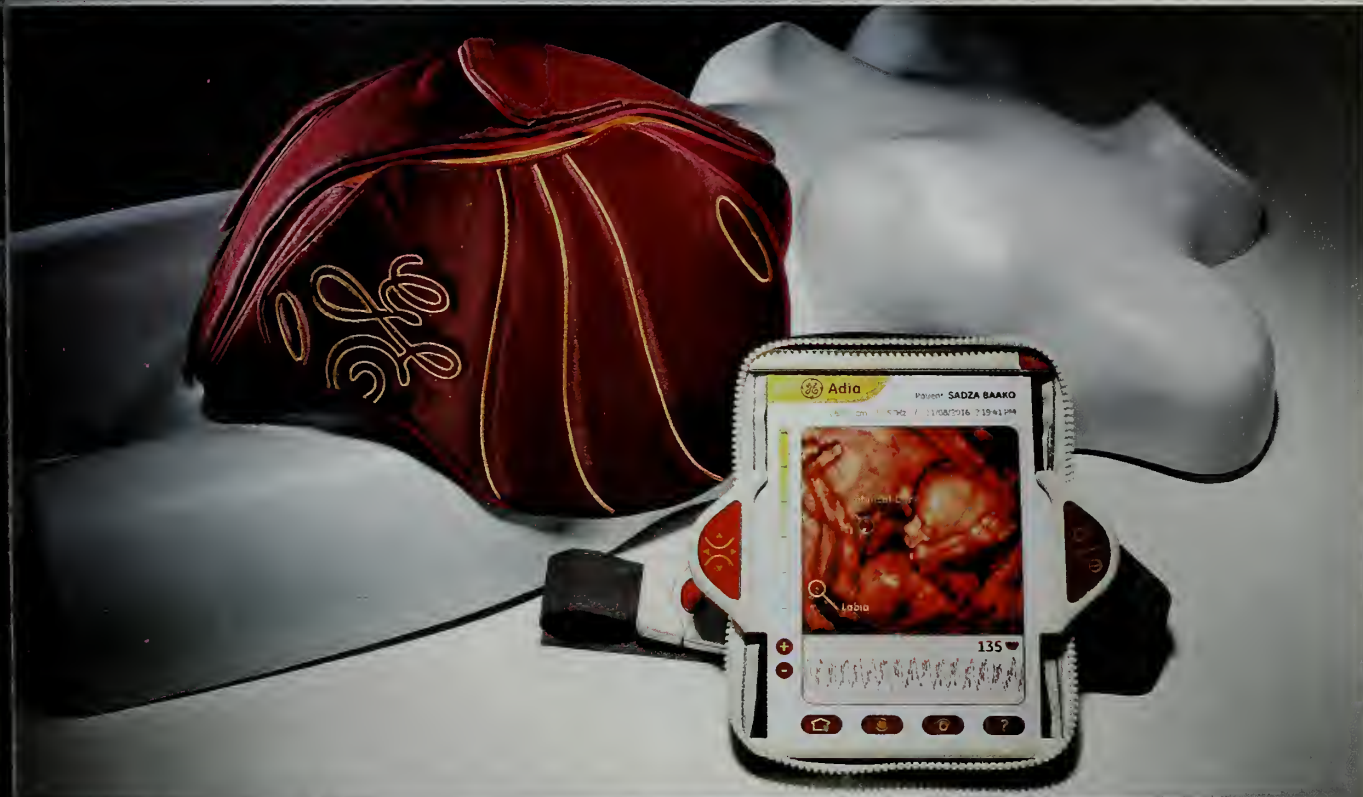
A noninvasive malaria scanner would detect disease by looking through the skin of a patient's hand. Malaria is currently diagnosed with a needle prick and a blood test. That scares some patients away and can delay treatment until results come back from labs. The scanner would be painted in earthy African colors.

Personalized mosquito netting would be dyed with colored insect repellent. Rates of malaria can drop as much as 80% in villages that use bed nets. Allowing people to personalize them might increase their willingness to use the nets.

A radio bracelet would alert a midwife when a pregnant patient is in trouble. Modeled on West African jewelry and decorated with indentations that resemble ritual scarification, it would be called *Akuaba*, a word associated with fertility in West Africa.

A dirigible would transport mothers-to-be with complications from remote regions to an acute-care hospital. The idea won praise for addressing a major problem in developing countries, the lack of infrastructure.

Companies typically pay \$100,000 to sponsor a semester-long Art Center course. For its money, GE got a fresh perspective. Many of the projects stretched the imagination—floating clinics powered by river currents, probes that test for parasites in water and shoot out red warning flags. That was the point. The students encouraged GE Healthcare to reconsider the possibilities.





Meet Sugar, the face of the \$100 laptop and a quantum leap in design

The \$100 laptop that's being created for school children in developing nations is known for its bright green-and-white plastic shell and its novel hand crank for generating power. What has not received much attention is the graphical user interface, called Sugar. It's the machine's face to the children who will own it—and it is revolutionary.

Sugar represents the first complete

rethinking of the PC user interface in more than 30 years. Ever since the Apple Macintosh was launched in 1984, PCs have been designed with the office desktop as the visual metaphor. Sugar tosses out all of that. Instead, it puts an icon representing the individual at the center of the screen, then “zooms” out like a telephoto lens first to show the user in relation to friends and then to all of the people in the village who are con-

nected via a Wi-Fi network. "We're actually building something that's right for the audience," says Chris Blizzard, the project leader for Sug at the nonprofit One Laptop per Child (OLPC) in Cambridge, Mass. "We don't just take what's already there and say it's good enough."

Nearly a dozen countries, including Brazil and Thailand, have committed to using the PC, now officially called XO. About 2,500 test models cur-



Clayton Christensen
Malcolm Gladwell
Renée Mauborgne
Ray Kurzweil

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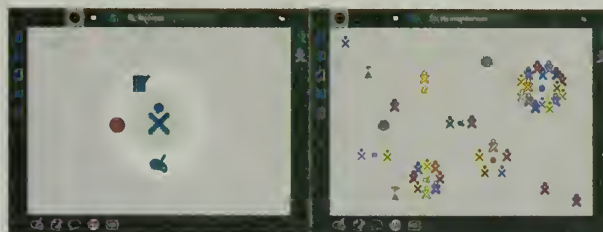
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THE WALL STREET JOURNAL

BusinessWeek

ntly are being shipped so teachers
d children can try them out. (Some
tsiders fault the OLPC group for
t getting their formal input earlier.)
e final version is supposed to be
idy by August.

Sugar has a look and feel all its
n. When you start up the machine,
a see the image of the so-called
Man, an O on top of an X, in the
ddle of a circle. Around the edges
the display, there's a dark frame
ere icons are placed that represent
activities that can be performed
ng the PC and its three different
odes: home, friends, and neighbor-
ood. The activities include e-mail, a
mple word processor, a photography
ogram (XO has a built-in camera),
Web browser, instant messaging,
d an electronic book reader.
When children are operating in
ne mode they see the XO Man,
d when they click on an icon on
frame to launch an activity, the
aivity takes up the whole screen. In
friends mode, they see XO Man



icons representing their friends,
each identified by nickname.
Next to the friends are icons
depicting the activities in which
they're engaged. If several friends are
working on an activity together on
their laptops, such as a school report,
they are pictured clustered around the
icon for that activity. Kids can ask to
be invited into a group activity or can
start one of their own. The neighbor-
hood mode is a broader view of all of
the individuals and clusters of friends
on the network.

Sugar is designed to encourage
students to explore how it works and
to make improvements. If one of the
students is playing a game, he or she
can actually look at the software code

Aimed at school-
children, XO scraps an
office setup in favor of
more personal icons

for the game and
modify it—perhaps
changing the colors
on the screen.

The software offers
a simple technique
for moving things
from one application
to another. A student
can pluck a photo off
a Web site and drag
it to the left side of

the frame. Then, after she launches
another activity, such as the word
processor, she can click on the icon
for the photo and drag it onto the
activity screen.

Sugar is open source, built on top
of Red Hat Linux. Any programmer
can look at the core software code
on the OLPC Web site (<http://www.laptop.org>) and suggest how to make
it better. While Sugar's impact will
first be felt in rural villages in Asia
and Africa, the new interface may
spark new thinking about designing
for the networked world.

The best professors
in the
WORLD
don't like hearing themselves speak



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ARE YOU DARDEN MATERIAL?

A chorus of voices is calling for an end to the hype—and a focus on what really drives profitable innovation

In one 30-second TV spot last year, former Ford Motor Chairman and Chief Executive Bill Ford used the word “innovation” nearly once every eight seconds. “If you look at the Ford Motor Co., innovation has driven everything we’ve done,” he began. The repetitions felt like a mantra by the time Ford concluded: “Innovation will be the compass that guides this company going forward.”

That campaign has by now been abandoned—perhaps because by the end of 2006, Ford was awash in red ink. Only a year after it heralded innovation as a core value with the launch of those ads, the auto giant posted an unprecedented loss of \$12.7 billion, surpassing its previous record loss of \$7.39 billion set in 1992. The ill-timed TV spot illustrates how companies are flying the innovation banner, hoping if they simply shout the magic word loudly enough, consumers will buy their products. Ford’s experience shows that people want the real thing.

A backlash against “innovation” (and “design”) is now under way. The constant incantation of the I-word in advertising, marketing, and conferences threatens to undermine a key business movement. Yet it is important to distinguish real innovation from the fad. Kevin McCullagh, author of a provocative essay, “Beware the Backlash: A rising tide of disaffection towards design,” that appears on the Web site Core77, says of innovation, “The term has been overused and abused of much of its meaning, with every lame brand-tweak and extension being hailed as an ‘innovation.’” Yet McCullagh, director of London-based consulting firm Plan, adds: “I don’t think there is much evidence of consumers getting tired of innovation. Look at the widespread hunger for a better cell-phone experience that the iPhone is tapping into.”

A wave of other articles, books, and studies from major consulting firms, business school professors, and design experts have appeared. They aim to get beyond the craze.

The flaws in the innovation mantra recently were exposed when Ford topped the list of a leading survey, *Smart Spenders: The Global Innovation 1,000*. At the

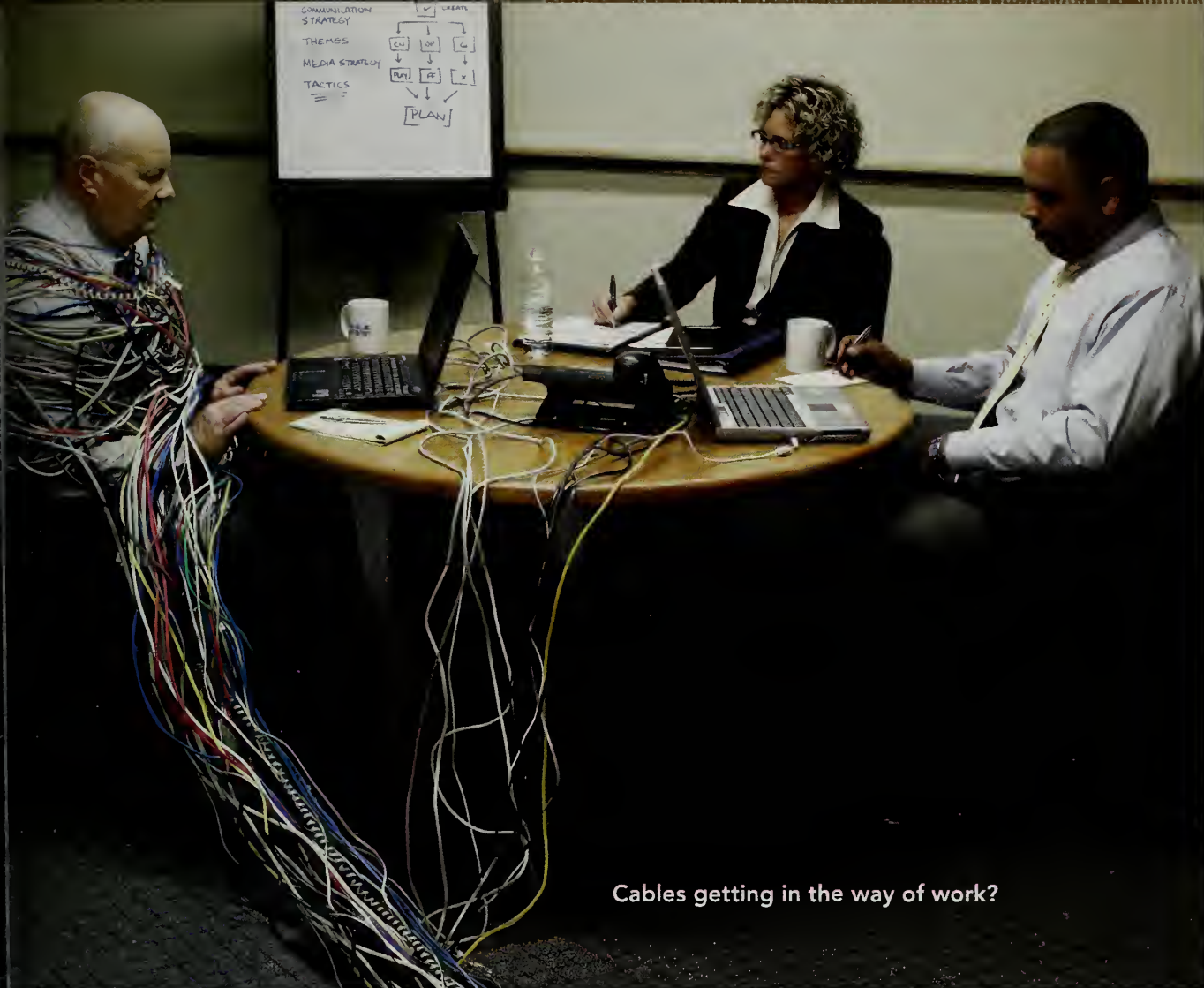
same time, this latest Booz Allen Hamilton report on research and development spending concluded that throwing billions of dollars at R&D to produce more patents doesn’t always translate into innovations that help a company’s bottom line. iPod creator Apple, for instance, has one of the lowest ratios of R&D spending to revenues.

In “Innovation: The Classic Traps,” published in the *Harvard Business Review*, professor Rosabeth Moss Kanter of the Harvard Business School says the most common mistake companies make is to apply traditional corporate processes to new projects. Truly innovative pursuits are hard to forecast or measure in traditional ways. A company can’t measure the success of a cutting-edge product using the metrics it applies to its existing goods.

Companies pursuing innovation strategies must be flexible, according to Kanter. “Applying one-size-fits-all thinking to new ideas is a big mistake,” she writes in an e-mail. Managers should keep communication open between people working on traditional products and teams looking at new ideas. That “ensures that when it is time to fold the innovation into the flow of the mainstream business people understand it and are ready for it.”

In *Payback*, published by the Harvard Business School Press, authors James Andrew and Harold Sirkin of the Boston Consulting Group emphasize the obvious: The “only worthwhile innovation is profitable innovation.” They advise ditching unprofitable ideas early even if they are brilliant and revolutionary—think Motorola’s Iridium satellite phone initiative—and moving on. Sirkin urges executives to focus instead on the return on their innovation investments (ROI). “There’s a belief that innovation is about great ideas,” he says. “But it’s about bringing a great idea to market, and maximizing the payback on the investment made in the idea.”

The message from all the backlash? Innovative products, services, and experiences drive profits—but only pursued with return on investment, rather than marketing, in mind.



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he government. On Feb. 22, Porter ed Saif in Tripoli to announce the ch of a Libyan Economic Develop- it Board designed to speed govern- it decision-making and boost private erprise. Saif also promised to more a double compensation for state oloyees, whose salaries have been en at low levels for years. (A typi- engineer, for example, makes about 0 a month.) And while he wants to nk the state sector by some 20%—or 000 workers—those who leave will ven three years' salary, plus loans of ,000 to start businesses. "We need hange from a state economy to an n economy," Saif told reporters, "but out it being out of control."

his balancing act is likely to con- tinue as Libyans wait to see whether Qad- dafi is truly serious about reform. "We are getting more comfortable, but lots of people don't feel confident," says one Libyan businessman. For decades, Qaddafi confiscated business- es and homes and treated enemies with brutality. Fear still lingers in the Trip- lian, and hotel rooms and restaurant s are said to be bugged. Moreover, isn't the only Qaddafi son with his ur's ear. Saadi, a former professional er player, and Mohtassem, the chief f intelligence, also vie for influence.

at many business leaders believe e regime is finally listening. In 2003, g up was allowed to form a business cil, which successfully lobbied for nterest rates. Recently, council ebers prevented a project to build n they considered to be an overpriced u mill that was backed by Maltese vitors. Instead, a cheaper \$15 mil- ian-backed facility got the green g. "We were kept out of [projects in] n country for years, and we want it," says Abdalla M. Fellah, a former cil chief who will invest in the mill. reign investors in Libya will have ck on with such nationalistic sen- ts, so future deals won't come s—just as nothing in Libya does. ut the reward—a foothold in one of e world's great oil producers—is well on it, many foreign executives be- y. As Mohamed Zeyani says: "Some- n is happening. It may be slow, but s happening." ■

CHINA

RUMBLES OVER LABOR REFORM

Beijing's proposed worker protections are giving multinationals the jitters

BY DEXTER ROBERTS

ONE REASON MULTI- nationals love China is its malleable work- force. That looks set to change with the im- pending passage of a new labor contract law that will make it harder to hire and fire, ultimately boosting the cost of doing business in the country. Under the law, "the hiring cost for employers will rise, the flow of labor will be further restricted, and the employment relationship will be more unstable," says Ma Jianjun, chairman of the Labor Commit- tee of the Shanghai Bar Assn.

The new law, likely to pass this spring, will usher in a raft of regulations similar to those in pro-labor European countries. Probationary periods for new hires will be shortened to as little as one month, while the use of short-term contracts will be re- stricted. And when companies are down- sizing, they will have to base decisions not on workers' abilities but on factors such as whether they have dependents. "Dis- tressed companies may be forced to lay off more qualified employees and employees in critical positions while retaining less essential personnel," the American Chamber of Commerce warned in a statement submitted to Chinese authorities.

That comment is one of more than 190,000 the government has received on

the proposed law—an unprecedented level of public discussion of legislation in China. The debate spurred Beijing to tone down some of the measures. For instance, a sec- ond draft, released in December, no longer requires management to get China's of- ficial trade union to sign off on important staffing decisions, though labor bosses must still be consulted. "We have enough investment at stake that we can usually get someone to listen to us if we are pas- sionate about an issue," says Scott D. Slipy, director of human resources in Chi-

na for Microsoft Corp., which worked with the Chamber of Com- merce to make its con- cerns heard.

Some foreign inves- tors support the law. Those who buy goods from Chinese-owned factories hope it will cut down on worker abuse—and bad press. And they're hoping that turnover rates, which run as high as 100% a year, could come down if workers enjoy stron- ger protections. "We see it as a huge stabilizing force if there is an up- front contract enforced in factories," says Auret van Heerden, CEO of

the Fair Labor Assn., an industry group that represents the likes of Nike, Adidas, Liz Claiborne, and Eddie Bauer.

Many companies, meanwhile, are wondering how vigilant Beijing will be. "The current labor law already is stronger than many in the region," says William Anderson, who oversees social affairs in Asia for sportswear maker Adidas Group. "But it all comes down to enforcement." ■



SAFE JOB Regulations could make it harder to hire and fire employees, like this textile worker in Beijing



EUROPE

A BACKLASH AGAINST PRIVATE EQUITY

Grumbling by unions over post-deal job cuts has escalated into a public outcry

BY KERRY CAPELL

FOR TITANS OF FINANCE, the annual Super Return Conference in Frankfurt is a chance to hobnob, broker deals, and attend sessions on topics such as "How big can financing, funds, and fees get?" But when legions of private equity heavyweights arrived at this year's conclave on Feb. 27, they faced union protesters brandishing placards saying "Conference of the locusts" and "Private equity equals asset stripping."

The small demonstration was just the latest protest against the growing clout of private equity in Europe—a trend not lost on the gathering. Inside the hall the talk often turned to why private equity's image has gotten so tarnished, how big an anti-private equity backlash might become, and what participants could do to restore a bit of luster to their corner of finance. "We're all trying to figure out how to deal with the onslaught of public equity," Texas Pacific Group founder David Bonderman told

the 1,700 delegates at the conference.

As the size and number of private equity deals multiply across Europe, opposition is brewing. Even in Britain, which boasts the most active private equity market in Europe, low-level grumbling by trade unions over job cuts has escalated into a public outcry. In recent weeks, Labour politicians and even City of London bigwigs have criticized the industry for its lack of transparency and the amount of debt foisted on takeover targets. "High levels of debt at a time when interest rates are rising could lead to a financially destabilizing environment," says Michael Hughes, chief investment officer at Baring Asset Management Ltd. in London.

The controversy has arisen at a time of unease in Britain over record numbers of corporate takeovers, huge bonuses and salaries in the finan-

LONDON Workers organized by union GMB outside 3i Group's offices

cial sector, and growing compensation gap between City of London and the rest of the country. "It's a shame that an industry that has contributed so much to the economy is suddenly seen as lightning rod for everything that ails British business," says Patrick Dunne, managing director at 3i Group PLC in London.

NO LONGER UNDER THE RADAR

THE TIPPING POINT came on Feb. 14 when a quartet of private equity firms said they were mulling a \$22 billion bid for British supermarket chain J Sainsbury PLC. "Until recently the firms had operated well below the radar screen of public interest," Richard Lambert, director-general of the Confederation of British Industry, noted in a Feb. 14 speech in London. "Now they have reached a point where that approach has to change."

The industry is making moves to get out in front of the issues—and to take one step ahead of regulators who may seek to rein it in. Notoriously media darling Damon M. Buffini, managing partner at Permira, Europe's largest private equity firm, is speaking out about the industry's need to become more open. "You have to look at the British car industry and understand that if you don't take action to put a business on a firm footing, things can go badly wrong," he said in a radio interview with British Broadcasting Corp. on Feb. 23. In addition to agreeing to meet with union leaders, Permira promised to reveal the names of its investors and provide more information about the companies it owns.

No doubt private equity has played a big role in London's success as a global financial center. Taking advantage of a strong economy and low interest rates, buyout firms have been able to boost vast amounts of cash, pay themselves hefty dividends, and give their shareholders high returns.

But with public scrutiny at an all-time high, industry executives are realizing that all it would take is one bad deal for regulators to crack down. Steven G. Pucci, head of private equity at Investcorp: "We need to do a better job explaining what we do."

—With Gail Edmondson in Frankfurt

THE STAT

\$68.4 Billion

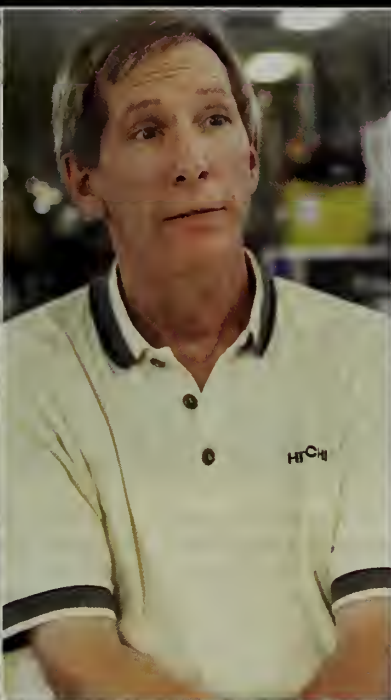
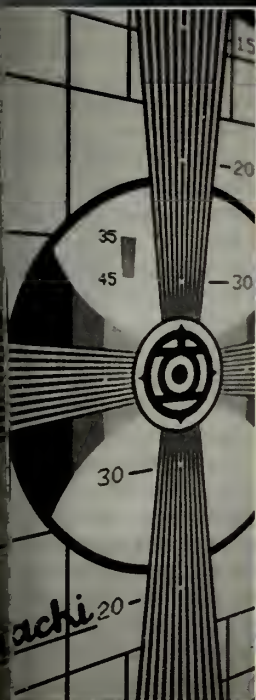
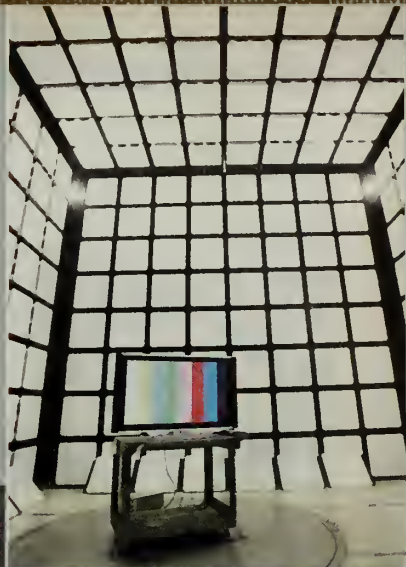
Value of private deals in Britain* (19% of all takeovers)

*2006 figures
Data: British Venture Capital Assn., Dealogic

Hitachi | true stories

THINKING THIN

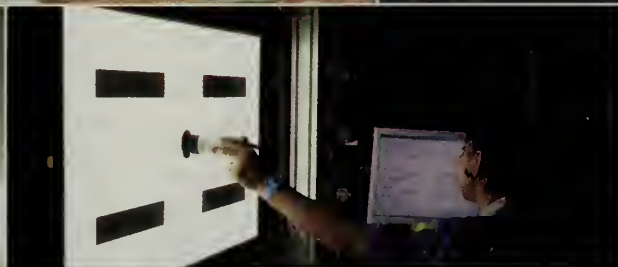
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EUROPE

TECHIES
ACROSS
THE POND

Europe's lively startup culture is attracting American talent

BY SPENCER E. ANTE

IN LATE 2000 A COUPLE OF STUDENTS at Stanford University's Graduate School of Business, Eric H. Baker and Jeff Fluhr, came up with a nifty idea to create an online ticket exchange. They launched the company in San Francisco, and it quickly took off. By 2003, StubHub Inc. had turned its first profit after selling \$60 million worth of tickets to baseball games and other events.

Soon, with StubHub thriving, Baker was ready for a second act, far from Silicon Valley. In 2005 he moved to London to launch viagogo, an online ticket agency for Europe, bringing five Americans with him. Baker had never lived abroad and moved with some trepidation. But the entrepreneurial energy in supposedly hide-bound Europe surprised him. "If you are plugged into the right networks, it's very reminiscent of what's going on in Silicon Valley," he says. "More and more people are going to wake up to the opportunity."

Baker is among a growing cadre of Americans jumping across the pond to join a newly dynamic startup culture. True, it's still harder to launch a company in Europe than in the U.S. But executives and venture capital-



BAKER
From San Francisco to London

ists say the number of Americans creating or running companies in Europe is on the rise. Says Neil Rimer, general partner of Index Ventures, a European venture capital firm: "We get more U.S. résumés than European résumés in some cases."

Dan Cohen, who headed the My Yahoo! business unit, now shuttles between Europe and the U.S. as CEO of Pageflakes Ltd., a German startup that two Germans and a Bangladeshi founded in 2006. European managers are hiring Americans, too. Last July, Brian Murphy, who helped build photo-sharing site Ofoto, was persuaded

by Moo.com founder Richard Moross to move to London and help launch an online photo-printing service as its vice-president of operations.

Techies cite a number of reasons why Western Europe seems so hospitable: top technical talent and more financing mechanisms such as angel investors, less competition than in America, and the

single European market. Venture funding of European tech companies rose 16% last year, to about \$2.8 billion. U.S. funding for tech startups rose at a far slower rate, 2%, although to a much larger \$13.8 billion total.

LEVELED FIELD

RECENTLY, LEADING U.S. venture firms Benchmark Capital and Accel Partners, with offices in London, raised money from two large European funds. "We're seeing the highest levels of entrepreneurial activity since we set up shop" in 2000, says Kevin E. Comolli, managing general partner of Accel Partners London, which last year raised a \$450 million fund. Accel is pouring money into open-source software, Web services, e-commerce, and media of communications groups in Britain, Germany, France, and Scandinavia.

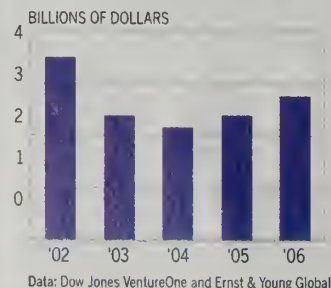
Europe has generated its share of innovative tech outfits through the years, of course, ranging from SAP software to Nokia Corp. in phones. But for a new generation of startups, the playing field between Europe and the Valley. A few years ago, entrepreneurs had to set up shop in the U.S.: The market was too big to ignore and it was difficult to be taken seriously as a European startup. Today, if an idea is innovative, the world beats a path to the door, says Mark Tluszczyk of Luxembourg venture firm Mangrove Capital Partners. He should know: In 2003 Mangrove invested \$130,000 in Skype, the growing Net phone company based in Luxembourg.

Skype, bought by eBay Inc. in 2005 for \$2.6 billion, is the polestar for new startups. But it's not alone. Sweden-based MySQL is a leader in open-source database software; Britain's Last.fm is being ground with a social networking site for music; and Madrid-based FON, launched by serial entrepreneur Martin Vars, is building a global wireless-communications network. "Thanks to Skype, I got proof that you can build a company in Europe that can be big," says Baker. "It is a huge inspiration."

—With Gail Edmondson in Frankfurt

A EURO MINIBOOM

European tech investment by venture capitalists is on the rise, though still off the dot-com boom



INTELLECTUAL PROPERTY

AN IDEA INCUBATOR TRIES TO GROW CASH

The Fraunhofer Society invented MP3—but others have reaped most of the profits

JACK EWING

GERMANY'S FRAUNHOFER Society, a sprawling collection of 56 scientific research institutes, has played a big role in developing technologies ranging from medical sensors to solar energy to car air bags. Its biggest invention may be blasting the latest U2 or Red Hot Chili Peppers into your ears right now. The MP3 standard for digital music to Napster, iPods, and a massive disruption of the recording industry. It was the work of a half-dozen researchers at Fraunhofer in the 1980s and early 90s, as well as private groups such as Bell Labs in the U.S. The impact of that work came into stark relief on Feb. 22, when a federal jury in San Diego slapped

Microsoft Corp. with a \$1.5 billion judgment for using MP3-related patents claimed by Alcatel-Lucent, which now owns Bell Labs' intellectual property.

The court case is just the latest unexpected outcome of a project begun in the 1980s. While still in graduate school, Karlheinz Brandenburg began working on transmitting music via digital telephone lines. He later joined Fraunhofer and, after years of toil with colleagues at the society, helped MP3 beat competing technologies to become the global standard for digital music on the Internet.

For Germans, the invention of MP3 is a source of pride—and chagrin. MP3 patents generate tens of

millions of dollars in licensing fees for the nonprofit Fraunhofer. But the really big money went to non-German companies that make MP3 players, such as Microsoft, Sony, and, of course, Apple, which uses MP3 technology in its iPods and iTunes software. "We tried to push [the technology] to German companies, but they were often too slow," says Brandenburg, now 52 and director of the Fraunhofer Institute for Digital Media Technology in the eastern German city of Ilmenau.

THE NEW MUSE

ALONG WITH THE World Wide Web (the Internet browsing interface invented in Geneva but appropriated by Silicon Valley), MP3 has come to symbolize Europe's knack for missing tech opportunities. At Fraunhofer, at least, the soul-searching had an effect. The society, founded by the German government in 1949 to conduct research for industry and defense, began to focus on profiting from its inventions. For example, Fraunhofer began giving seed money to start-ups using its technology. One is Iosono, a spinoff 25% owned by Fraunhofer, which makes equipment to produce super-realistic sound in theaters.

Perhaps most important, MP3 has been an inspiration to Fraunhofer's 12,500 researchers. Many of them work in relatively unglamorous fields such as power-plant technology or auto electronics, with most of the credit for their work going to companies such as Siemens and DaimlerChrysler that provide financing. "Whenever you have a real champion, that increases motivation for the whole organization," says Ulrich Buller, a member of the Fraunhofer executive board.

Fraunhofer could use a boost. The outfit gets only 20% of its budget from the German government and needs to earn the rest from contract research. MP3 royalties, meanwhile, fell 45% last year, to \$78 million, as the initial surge of companies buying licenses has subsided. Still, the nonprofit is forging ahead with work that builds on its MP3 expertise. In January, Fraunhofer unveiled the latest version of MP3 Surround, which creates the illusion of surround-sound with standard stereo speakers. Not bad for something that started out as a grad school project. "I did not believe," says Brandenburg, "this would affect hundreds of millions of people and change the whole music industry." ■

POWER CRAZY

A worker at Fraunhofer's Solar Energy Systems



Avon: More Than Cosmetic Changes

How Andrea Jung is trying to stop the sag by getting smarter about the numbers

BY NANETTE BYRNES

IN 2005, AVON PRODUCTS INC.'S success story turned ugly. After six straight years of 10%-plus growth and a tripling of earnings under CEO Andrea Jung, the company suddenly began losing sales across the globe. Developing markets such as Central Europe and Russia, the engine of Avon's amazing run, stumbled just as sales in the U.S. and Mexico stalled. The global diversity that had long propped up the company's performance suddenly began to weigh it down.

This dramatic turn of events hit investors by surprise. In May, Jung had predicted Avon would exceed Wall Street's already high expectations. By September, problems in China, Eastern Europe, and Russia were mounting, and Jung was backpedaling at full speed. Angry shareholders bailed out. The stock price, which had risen 181% during Jung's first 5½ years at the helm, plummeted 45% between April and October.

Over the past 18 months, Jung has tried to figure out what went wrong and how to fix it. While it's far too soon to celebrate at Avon, the company is emerging from Wall Street's doghouse. Avon sells Skin So Soft and ANEW skin-care

products as well as makeup and other items through a network of 5 million independent representatives. Its stock had jumped 39%, to 36.65, by Feb. 27, from its lows of last August. Investors are happy about, among other things, Avon's progress signing up 399,000 new salespeople in China, where a fast-growing middle class is compelling enough to outweigh the government's tight regulation of direct sellers. Renewed growth in Central Europe and the U.S. is helping, too. For the fourth quarter of 2006, revenue rose 9%, to \$2.6 billion, while net income stayed flat at \$184 million.

PAINFUL CUTS

ALTHOUGH SHE acknowledges continuing problems, Jung felt comfortable enough with the company's progress to give *BusinessWeek* her first extensive interview since Avon's 2005 collapse. An expert in building brands, Jung had no turnaround experience when she arrived in her job. At times she doubted that she could make the deep staff cuts needed to right the company. "I'd never done anything like that before," said the 48-year-old Jung on Feb. 15. "My first reaction was: 'I get it. I see the numbers, but I just don't know if I, or we, have the stomach for it.'"

One of Jung's most important moves has been forcing managers to make decisions based on fact rather than intuition. In the past year, she has reorganized Avon's management structure, taking away much of the autonomy from country managers, in favor of globalized manufacturing and marketing. Previously, Avon managers from Poland to Mexico ran their own plants, developed new products, and created their own ads, often relying as much on gut as numbers. In Jung's words they were "king or queen of every decision."

Now Jung has trimmed out seven layers of management, bringing the total from 15 down to 8, and finally launched the kind of numbers-heavy return-on-investment analysis that most large consumer products companies have been doing for decades. That analysis is directed from New York headquarters by an executive team stocked with more people from outside. Recent recruits have come from larger, more analytical consumer products companies such as Gillette, Procter & Gamble, PepsiCo, and Kraft. "I speak about what we have to achieve our goals, she is so much closer to the operations" now, says board member Paula Stern. "She has her hands on the levers that have to be moved."

At the height of Jung's problem in December, 2005, management guru Ram Charan gave her a piece of pivotal advice. He advised Jung to go home that night and imagine she had been fired. Then, he said, return Monday morning

Needed: A Makeover

By 2005, Avon had a raft of ugly problems to solve. Here's how Andrea Jung has tried to deal with them:

PROBLEM

POOR SALES In 2005, 82% of Avon beauty sales were being discounted, but revenue growth had still slowed dramatically.

WEAK COMMUNICATION As late as May, 2005, Jung was telling analysts the company would exceed expectations, but big problems were percolating around the globe, unrecognized.

BLOAT Overhead had reached \$2.5 billion. Manufacturing, marketing, and compensation were being handled locally with little efficiency of scale.

ACTION

Jung eliminated 25% of the company's products, increased advertising 83%, and boosted reps' pay in key markets.

Jung cut out seven layers of management, and began studying performance market by market in a more rigorous and scientific manner.

Jung reorganized the company into a structure where more decisions about manufacturing, marketing, and compensation would be made on a worldwide basis.



the mindset of someone brought from the outside. "If you can be that positive and blend in your institutional knowledge and relationships, you're going to have an advantage," he told her. A month later Jung was flying around the globe on a CEO roadshow, addressing audiences of her top 1,000 global managers. Her message: By the end of this year, a quarter of you will be gone. "I put a lot of people in those jobs," says Jung, "you can imagine it was the toughest thing to walk the halls."

ANALYZE THIS

ANALYSTS' NEW EXECUTIVES and their new faces were on display at the annual analysts' conference, held in New York on Feb. 15. Ironically, this show was heavy on product announcements and ad clips. But this edition contained nearly four hours' worth of PowerPoint slides. In them, the companies provided a detailed explanation of what had gone wrong in many of its 114 worldwide markets.

THE REVELATION: The roster of products in Mexico had ballooned to 13,000. To make matters worse: Decreasing the payoffs for adding new representatives had stalled the sales business. At times analysts seemed to think that Avon could have been so out of touch with the basic forces that drove

its own business. "Why," asked Deutsche Bank analyst Bill Schmitz, about 3½ hours into the meeting, "did it take a year and 8,000-plus [representative] surveys to figure out that people want to work less and earn more?"

It was a rebuke, but one Schmitz made with good humor. Schmitz is one of five analysts (out of 15) who rate the stock a buy. Avon's appeal to them is that it gets 70% of sales outside the U.S., much of that from still-developing markets. Even Jim Cramer, who put Jung on his "CEO wall of shame" and recommended selling the stock last summer, has changed his mind, apologizing to Jung on his show *Mad Money* just a week before the analysts' event.

Avon's new data-centric approach isn't just about creating a good set of slides, however. It's also helping to change Avon's marketing and product development. Avon sells many thousands of products, and 1,000 of those have been introduced in the past 12 months. Savings from centralized manufacturing and other initiatives are being put into advertising and research and development, a strategy Jung hopes will get earnings climbing again.

Avon increased its ad budget from \$136 million in 2005 to \$249 million in 2006. This was a big factor in the company's 6% sales growth in 2006.

Avon had planned to raise advertising to \$200 million, but good returns on TV ads in Brazil, the U.S., and Russia, along with other marketing pushes, persuaded management to add a further \$49 million, for a total increase of 83%. Avon is also doing more marketing to spark recruiting. Last year the company ran TV and newspaper ads supporting 1,400 recruiting events in China. In Russia the company sponsors a TV show featuring a character who sells Avon.

Jung's No. 1 role continues to be communicating the company's new strategy. In the weeks leading up to and just after the February analysts' gathering, Jung visited Bangkok, Hong Kong, London, São Paulo, Shanghai, and Warsaw. All that travel comes at a sacrifice. Jung has a daughter who will graduate from high school this spring and a son who is 9. She says she has completely reprioritized her life in the past two years, skipping business dinners and formal evening affairs in order to be sure she sees them when she's in New York. But she also tells her children that she loves the company and the work, even if it has been grueling in recent months. "I think it's important they know that," she says. "Otherwise why would you do this?" ■

Who's Really Shaking Up Heinz

It's not activist investor Nelson Peltz driving growth. It's the CEO

BY AARON PRESSMAN

SHARES OF H.J. HEINZ had been on the skids for years when hedge fund activist Nelson Peltz stepped in, buying a 5.4% stake in the ketchup giant last March. Fresh off his fight at restaurant chain Wendy's International Inc., Peltz, founder of Trian Fund Management, almost immediately launched a nasty proxy battle to oust five directors. When the dust settled, Peltz and an ally, former Snapple Beverage Group CEO Michael F. Weinstein, had muscled their way onto the board.

Now the stock has bounced back, up more than 25% since Peltz's arrival a year ago. What's more, revenues at Heinz rose 6%, to \$6.6 billion, for the first nine months ending Jan. 31, while profits increased 27%, to \$605 million.

On the surface, it would seem to be the usual tale: Activist buys shares, activist clamors for change, activist cleans up company. But Peltz, who on Feb. 26 disclosed that his fund now owns a 5.5% stake in jeweler Tiffany & Co., doesn't get the kudos in this case. "Trian just deserves credit for identifying an undervalued stock," says Deutsche Bank analyst Eric Katzman, who notes that Peltz's contribution to Heinz's turnaround has been "minimal." Peltz declined to comment.

This time, management gets the pat on the back. Chief Executive William R. Johnson, who became CEO in 1998, has spent the past couple of years spiffing up the company by dumping underperforming units like StarKist Tuna and

Heinz pet food while slashing costs and reducing customer discounts to the tune of \$500 million a year starting in mid-2008. He's plowing those savings back into product development and marketing, as well as restocking the executive suite with consumer-product heavyweights from Procter & Gamble, PepsiCo, and Mattel. The strategy has paid off, especially in Heinz's mainstay, ketchup. New products, like the easy-to-store Heinz Fridge Door Fit Ketchup, as well as attention-grabbing gimmicks like labels consumers can customize over the Web have brought buzz to a once-tired brand. Driven by such efforts, ketchup and sauce sales rose 6% in the past three quarters.

Johnson has kept on track despite a distracting slugfest with the hedge fund manager. The battle turned personal last May when Heinz issued a press release complaining that Peltz's nominees were all close friends, employees, or relatives. Heinz attacked again a month later, pointing out Peltz's prior misdeeds, such as a lawsuit he settled for \$70

million and a public censure from London Stock Exchange. Peltz issued his own press release, calling charges "misleading, baseless, self-serving," while blasting Heinz financial record under Johnson "abysmal." He then fired back a list of seven Heinz directors involved in shareholder lawsuits at other companies. Heinz brushed off the charges as run-of-mill litigation. With the fight intensifying, the Securities Exchange Commission warms both sides over the summer ease off the mudslinging proxy filings.

DETENTE

MEANWHILE, JOHNSON crisscrossed the globe, trying to assuage other shareholders and boost employee morale. At a meeting with staffers last month in London, Johnson repeated only a single reference to the Peltz matter in his 20-minute speech: "The best thing we can do for Heinz is to stop growing your brands."

In the end, Johnson braced his adversary. These days, the two often talk by phone about ideas or concerns. While analysts once worried Peltz might push short-term moves to boost stock—like drastic cost-cutting at the expense of long-term investment in product development—Johnson says that hasn't been the case: "He's been collegial and collaborative. The focus is on new ideas to drive innovation and create value."

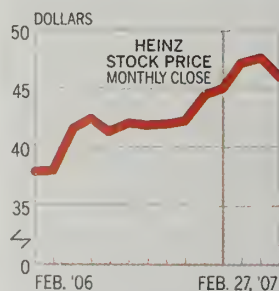
Indeed, innovation has become a point, which should help fuel growth, especially in the sluggish European market. The company plans to launch new products, including a line of organic roasted potatoes in fiscal 2008, which begins in May. In all, earnings per share is expected to rise 10% this fiscal year and 8% more in the next.

It's not only investors who now find Heinz appealing. UBS analyst Palmer thinks Kraft Foods Inc. will be fully spun off from cigarette parent Altria Group Inc. in March, with its sights on Heinz. "Heinz would be a very short list of companies that we would add significant international presence to," Palmer says.

Johnson isn't distracted by the noise. He is focused on running the company, creating shareholder value through organic results. ■



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Hugging the Tree-Huggers

Why so many companies are suddenly linking up with eco groups. Hint: Smart business

BY JOHN CAREY

WHEN WILLIAM K. Reilly was plotting the private equity takeover of Texas utility TXU Corp., he foresaw one potential dealbreaker.

It wasn't the money. The two main investors—Texas Pacific Group, where Reilly is senior adviser, and Kohlberg Kravis Roberts & Co.—wouldn't have any trouble financing the \$45 billion deal. Nor was it about getting regulatory approval. Instead, says Reilly, "we decided the walk-away issue for us was not getting environmentalists' support."

So Reilly called Fred Krupp, president of Environmental Defense, whose Texas attorney, James D. Marston, had been waging an all-out war on TXU's plans to build 11 coal-fired power plants. Krupp told Marston to hop on a plane to San Francisco for a top-secret meeting with Reilly's team. "I ran home, got a suit, took the dog to a kennel, and told my wife I loved her but couldn't tell her what it was about," says Marston.

The ensuing negotiations were often tense. Enviro referred to TXU's expansion plans as the "*Mein Kampf* of the global warming wars." When Reilly heard that, he recalls telling his colleagues: "This will be harder than I thought." After a marathon 17 hours, Reilly ended up giving Marston a big chunk of what he wanted: commitments by the new TXU owners to ax 8 of the 11 proposed plants and to join the call for mandatory national carbon emissions curbs. Meanwhile, the corporate raiders got exactly what they craved: public praise from Environmental Defense and the Natural Resources Defense Council (NRDC) for the deal.

Why was that so important? "We all swim in the same culture—and the culture is going green," explains Reilly. Indeed, Americans find nongovernmental organizations, like green groups, more credible than business, according to the Edelman Trust Barometer, an annual survey. That's a switch from five years ago, and it gives activists additional clout. "Companies have to be seen as responsible," says Karen Van Bergen, vice-president of McDonald's Europe.

The TXU takeover is a sign of a remarkable evolution in the dynamic between corporate executives and activists. Once fractious and antagonistic, it has moved toward accommodation and even mutual dependence. Companies increasingly seek a "green" imprimatur, while enviros view changes in how business operates as key to protecting the planet.

Examples of this new relationship are as ubiquitous as Al Gore at the Academy Awards. Wal-Mart Stores Inc. turned to Conservation International to help shape ambitious goals to cut energy use, switch to renewable power, and sell millions of efficient fluorescent bulbs. When the CEOs of 10 major U.S. corporations converged on Washington on Jan. 22 and issued a call for mandatory carbon emissions limits, sitting with them at the table were Fred Krupp and the president of the NRDC. And after Silicon Valley Toxics Coalition activists got Dell Inc.'s attention by chaining themselves to computer monitors, they worked with the computer maker on a groundbreaking recycling plan. "Companies have decided it is better to invite us into the tent than have us outside picketing their keynote speeches," says Silicon Valley Toxics Coalition founder Ted Smith. "It's a long way from where we started."





Sometimes green groups can't tell if the bonhomie is just a PR ploy

Twenty years ago, for instance, current Greenpeace International chief Gerd Leipold was cruising the Rhine, taking action against corporate polluters. He and his comrades would block pipes spewing effluents into the river and sometimes pump the waste back. Now he can be found wearing a pinstripe suit, standing with CEOs, and heaping praise on companies he sees as doing the right thing. "We've shifted from just pointing out the problems to pushing for real solutions," says Leipold. "When congratulations are deserved, we offer them."

For companies, alliances with environmentalists can help both the bottom line and the public image. "We used to see Greenpeace as the enemy," says DuPont CEO Charles O. Holliday Jr. Now DuPont employs Paul Gilding, former head of Greenpeace International, as a paid consultant, and the company ranks high on lists of green leaders. "We work with our enemies," says Holliday.

ACCUSED OF SELLING OUT

OF COURSE, there are limits to this cooperation. Greenpeace is so anti-nuke that there is no room for discussion with utilities pushing nuclear power plants. And collaboration can be a tricky balancing act. Anthropologist and law professor John M. Conley at the University of North Carolina at Chapel Hill believes that environmentalists' shift from accuser to partner might co-opt and defang the activists. Even though the mainstream groups adamantly refuse corporate money, they could lose their edge. "Would *Silent Spring* have come out of a stakeholder dialogue?" Conley asks, referring to Rachel Carson's 1962 environmental opus.

Indeed, Greenpeace and others have been accused of selling out by some of their own members. Leipold admits that it's often hard to tell if companies are

using activists' support as mere PR, or "greenwashing." But executives' original motives may not matter, he asserts. Once a company commits to phasing out toxic fire retardants, as Dell has, or to slashing energy use and greenhouse gas emissions, on the model of Dow Chemical Co., then activists can hold them to the promises. Plus, Leipold notes, companies have hired "sustainability" gurus to

help them tackle social responsibility issues. "Even if the people who employed them are cynical, I think [the gurus] are turning out to be a subversive element in the companies," he says.

The green movement hasn't abandoned its swashbuckling tactics. Greenpeace's ship *Esperanza* has been cruising the Southern Ocean, ready to put itself between whales and the harpoons of Japanese whalers. But such tactics are often unnecessary. These days, the mere threat of bad publicity can force business to change. Executives remember how Nike Inc. took a beating over labor practices in the mid-1990s. "No one wants to be the next Nike," says Smith of the Silicon Valley Toxics Coalition.

That gives activists new power. On the eve of the 2000 Sydney Olympics, sponsored by Coca-Cola Co., Greenpeace launched an e-mail campaign against the soft-drink giant. The charge: using

Increasingly, the mere threat of bad publicity can spur business to change

a potent greenhouse gas in its 9 million to 10 million coolers and vending machines.

Coke responded quickly. "Our reputation is important to us. So rather than become defensive, we asked what we could do," says Jeff Seabright, Coca-Cola's vice-president for environment and water resources. Since then, Coke, PepsiCo, Unilever, and McDonald's have spent \$30 million developing a less damaging system, displayed at January's meeting of the World Economic Forum in Davos with a "technology approved by Greenpeace" banner. This image building has a bottom-line benefit. "Providing environmental value is becoming a competitive edge for business," explains Seabright.

SWITCHING GEARS

SOMETIMES EVEN THE traditional tactics don't work. Greenpeace tried to save old-growth trees in Alaska with a classic logging-road blockage. "It flopped," says John Passacantando, director of Greenpeace USA. The local press was hostile; the national press was bored.

So the activists switched gears. They traced the path of downed trees and found that old-growth spruce ended up in musical instruments. A year ago, Greenpeace warned guitar makers that the wood they need could disappear. "It

sent shock waves through the industry," says activist Scott Paul. Executives trekked to Alaska and are working on a plan to set aside land. "We are thankful they contacted us," says C.F. Mac & Co.'s Dick Boak. "It's great to have Greenpeace as a partner and ally."

There are some corporate holdouts. Apple Inc. is resisting Greenpeace's "green my apple" campaign, which calls for more recycling and fewer toxic chemicals. "We disagree on their criteria," says Apple's Steve Dowling. When the group targeted McDonald's Corp. for using chickens fed with soybeans grown on deforested land, the Amazon, McDonald's agreed to stop. But KFC refused to talk, denying that any of their chickens ate Amazon soy.

Meanwhile, chemical companies such as Dow know that the tree-huggers will stop criticizing them, no matter how much energy or how many greenhouse gas emissions they reduce. "Our job is to please or convince the activists," says Scott Noesen, Dow's director of sustainable development. "The best we can do is set meaningful targets and report on our successes and failures and dilemmas."

Still, Dow has given activists a seat at the table. In the old days, recalls Pacific Group's Reilly, former director of the Environmental Protection Agency, green activists were "banging the door trying to get into the room where decisions are made." Now they're in the room and hard to miss.

—With Michael Arndt in Chicago

Environmentalists at the Corporate Table

Longtime foes are finding common ground

- The takeover of **TXU** depended on winning support from Environmental Defense and the Natural Resources Defense Council. The enviros got commitments to slash the number of planned coal plants, support mandatory limits on emissions, and boost energy efficiency.
- Conservation International helped shape **Wal-Mart's** ambitious plans to cut energy use, switch to renewable power, sell efficient lightbulbs—and improve its image.
- Greenpeace worked with **McDonald's**, **Cargill**, and others to stop farmers from cutting down the Amazon rainforest to grow soybeans. In return, Greenpeace halted its protests against the multinationals (right).
- After activists got **Dell's** attention by chaining themselves to computer monitors, they helped Dell create a groundbreaking recycling plan.



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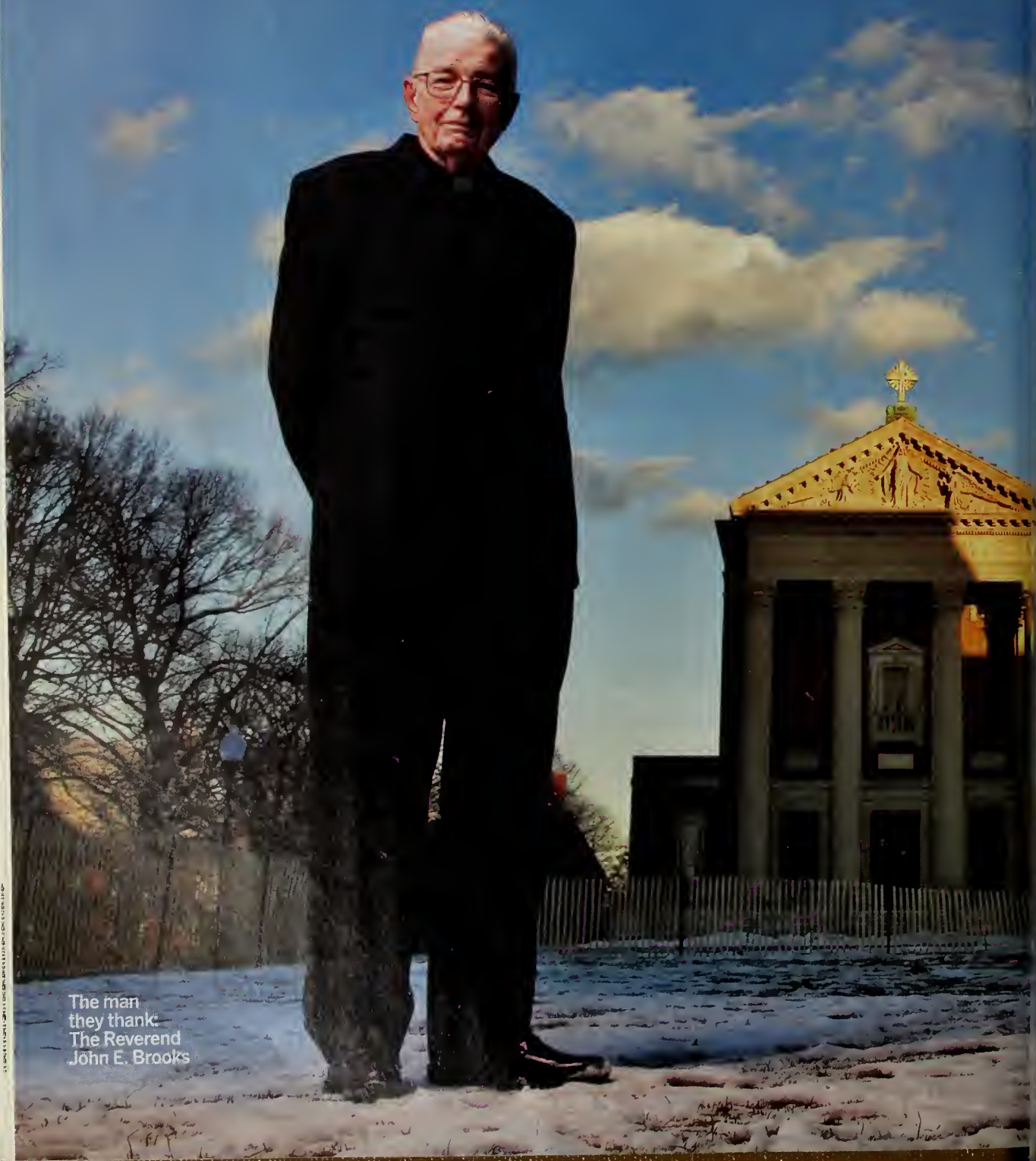


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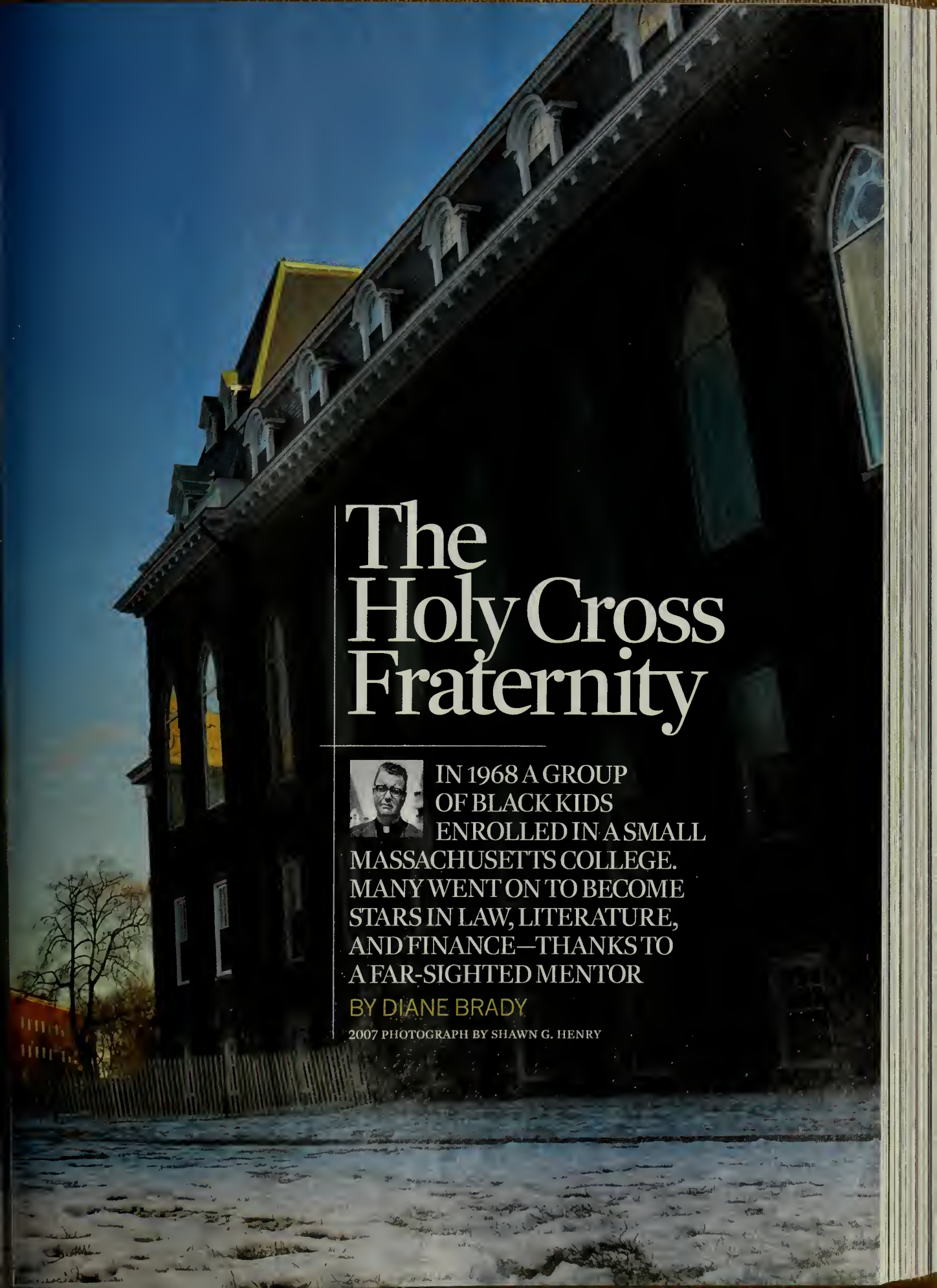


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IN 1968 A GROUP
OF BLACK KIDS
ENROLLED IN A SMALL
MASSACHUSETTS COLLEGE.
MANY WENT ON TO BECOME
STARS IN LAW, LITERATURE,
AND FINANCE—THANKS TO
A FAR-SIGHTED MENTOR

BY DIANE BRADY

2007 PHOTOGRAPH BY SHAWN G. HENRY

THEY ARE TWO OF THE MOST IMPORTANT MEN in American law: Clarence Thomas, arguably the most controversial member of the U.S. Supreme Court; and Theodore V. Wells Jr., the star litigator who is currently representing I. Lewis "Scooter" Libby, Dick Cheney's former chief of staff, on charges of lying in the Valerie Plame CIA leak investigation. Thomas is a Republican; Wells, a lifelong Democrat. Both are African American, but Thomas famously condemns affirmative action while Wells vigorously supports it in his capacity as co-chair of the NAACP Legal Defense Fund Board of Directors.

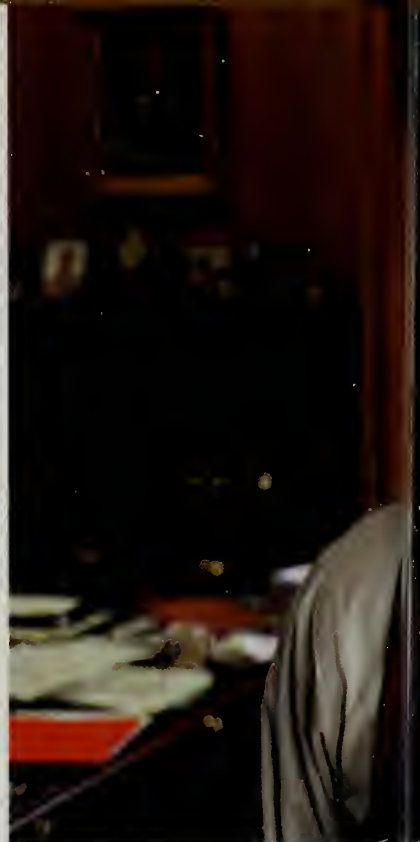
What binds them together is the experience they shared as students at the College of the Holy Cross and, in particular, the influence of the man who brought them there: the Reverend John E. Brooks. The men's bond with the Boston-born priest, now 83 and president emeritus, began almost four decades ago and remains strong to this day. "I love Father Brooks," says Thomas. "He's a great man." While Thomas "never liked school," the affection he feels for Brooks is so strong that he was willing to break a long-standing silence in the media to talk about him and the impact of that formative experience on his life. "Father Brooks realized we needed to be nurtured; that we were going to have unique problems," Thomas recalls.

The story of Brooks is important—and overlooked. A former academic dean who became president of the college in 1970, Brooks was by turns recruiter, mentor, negotiator, and friend to the 28 African American men who ventured to the Jesuit college in the largely white, industrial city of Worcester, Mass., during the racially tense fall of 1968. Brooks helped shape an exceptional group of overachievers. Along with Thomas and Wells, who was recently named 2006 Lawyer of the Year by the *National Law Journal*, this group includes Pulitzer Prize-winning author Edward P. Jones; investment banker Stanley E. Grayson, a former New York City Deputy

Clarence Thomas
Supreme Court Justice



"FATHER BROOKS REALIZED WE NEEDED TO BE NURTURED; THAT WE WERE GOING TO HAVE UNIQUE PROBLEMS."



Mayor who broke the color bar on Wall Street; and Ed Jenkins, a Miami Dolphins running back during the team's 1972 perfect season who now chairs the Massachusetts Alcoholic Beverages Control Commission. "I came to see Father Brooks as one of the greatest ambassadors of justice I've known," says Jenkins.

Brooks dared to single out black students for special attention in the belief that it wasn't enough simply to let them knock on the door. He went to inner-city schools to woo African Americans to Holy Cross, promising opportunity and scholarships but no academic breaks or special programs to ease the transition of the young men. "I was pretty confident that they were not moving to a friendly environment," says Brooks. What he gave them, Thomas was time, respect, and the freedom to be different. In a move that would probably prompt criticism today, Brooks enabled the men to create an exclusive community with special privileges. And he pushed them not only to meet but also to exceed the high academic standards of the school, helping to transform a group of talented students into college leaders. "From a statistical perspective, it seems incredible," says Wells, of his classmates' success. "Father Brooks' mentoring had a lot to do with it. We learned from him, and he learned from us."

Edward P. Jones
Author



BROOKS DROVE THE FUTURE PULITZER PRIZE WINNER TO CAMPUS FOR A VISIT.

"THE FACT THAT HE HAD DRIVEN DOWN FROM MASSACHUSETTS TOLD ME SOMETHING IN A VERY QUIET WAY."



The Courtship

IT WAS THE TUMULTUOUS STATE of race relations heightened by Martin Luther King Jr.'s assassination in April, 1968, that prompted Brooks to accelerate his recruiting drive for black students. "I thought it would benefit not just the African American students but the rest of Holy Cross as well," he says. "I wanted to open the doors to women, too." (Brooks was voted out of that, but he made coeducation his first initiative when he became president.) Jesuits, he argued, were supposed to educate leaders, and it was clear



ool of potential leaders was widening fast. That belief in order's mission was what had helped attract the young ics student, born the eldest of four children in 1923 to a phone company superintendent and homemaker, to the sts in the first place.

ooks was not alone at Holy Cross in his efforts to address l issues. "There was a warmth toward social justice from op in those years," recalls the Reverend Jesse Jackson. Brooks says he had to focus on Catholic high schools ly because the secular schools wouldn't let him in. Ed- P. Jones, who wrote the Pulitzer Prize-winning book *The on World*, was impressed that anyone would care about r kid from Washington like him. "The fact that he had n down from Massachusetts [to pick up Jones for a cam- isit] told me something in a very quiet way," he says.

to that point, there had been no particular interest inging African Americans to the nus. Arthur Martin, who graduated 1970, says he recalls one other black ent in his freshman class of 660. h word was Holy Cross could only e two or three of us a year," he e. When King died, Brooks secured y for Martin and another black nt to attend the funeral. He also ough money from the college to ull scholarships to every black stu- e and his colleagues later tried to rt—although, as he puts it, "people n't standing up, congratulating me nging black students in."

A of them came by different routes. as had been on the path to priest- ut a Missouri seminary when King ot. Already unsure of his calling, it after a white classmate glee- eacted by saying he hoped "the died." A Franciscan nun suggest-

ed Thomas head to Holy Cross. Although worlds away from the dirt-poor Georgia village where he grew up, he packed up what he says was a deep reservoir of anger and bitterness and moved north to enroll as a sophomore. "I was 20 years old," Thomas says. "I had no place to go. I had no road map. I had nobody to talk to, nobody to give me advice."

Wells arrived at Holy Cross with a football scholarship and social savvy beyond his 18 years. He had grown up in Washington, raised mainly by a mother who worked as a clerk in the U.S. Navy Dept.'s mailroom. Having attended public schools where most students were black, Wells admits the thought of "going to an all-male, predominantly white, Jesuit college on a hill in Worcester, Mass., was daunting." Wells had other offers but liked the balance of sports and academics and, more important, bonded immediately with Jenkins and Grayson, a top basketball player, during a campus visit.

Even so, there were signs that obstacles lay ahead. Jenkins recalls a football coach cheerfully saying: "You nigras are really going to like it here." And Brooks, though personally impressed with the intelligence and discipline of the African American recruits, faced tough questions from alumni about whether the candidates had the credentials to get in. Some of the recruits also had their own doubts. On his SAT scores alone, which he recalls as an unimpressive 532 on math and 489 on English, or his solid but unspectacular showing in school, Jones fails to see how he could have gotten there. "Five years earlier, Holy Cross would not have chosen me," he says.

The Arrival

BROOKS ANTICIPATED a high level of discomfort for the new arrivals, and he was right. Jones, although raised by an illiterate single mother in an all-black neighborhood, had naively expected to feel at home in what he had termed "the land of abolition." Instead there were constant looks and subtle rejections. He arrived to find his white roommate dashing around the residence, catching up with prep school friends. They never bonded. Says Jones: "His parents visited during the year, and he never brought them up to introduce them to me. Never." Another student asked: "Is it easier to get in here if you're colored?"

It didn't help, perhaps, that some people in the administration had tried to prepare for the arrival of black students by



Theodore Wells
Attorney



"FATHER BROOKS SHOWED THAT SOMEBODY AT THE HIGHEST POSITION IN THE ADMINISTRATION CARED ABOUT US."



calling up potential roommates to ask if they “would mind rooming with a Negro.” Recalls Grayson, “Nobody contacted me to ask if I would mind rooming with a white guy.”

Recognizing the challenges of the environment, Brooks allowed the black students to single themselves out. When Wells came to ask for a black student corridor, Brooks agreed even though he felt it was a bad idea. He helped them get the top floor of Healy Hall—an important symbolic gesture, as the building was named for Bishop James A. Healy, the son of an Irish immigrant and a slave, who was valedictorian in the first Holy Cross class, in 1849. “Sometimes, it’s better to let them do what they want and see if it works out,” Brooks explains. Thomas, who voted against the idea at the newly established Black Students Union, admits that the corridor “was one of the few comfort zones you could find.”

The Camaraderie

LIVING TOGETHER fostered a strong sense of fraternity among the men. The leader was Wells, who had quickly dropped football to focus on his studies (the move didn’t affect his scholarship). Brooks approved, believing it was more realistic to focus on a career that would tap his mental skills rather than his physical ones. (He also told basketball team captain Grayson: “You’re not here because you play basketball.”) The priest found himself spending a lot of time with Wells, talking about race issues, classes, and, as often as not, what the black students wanted on campus. “Ted always knew where he was going,” says Brooks. “He was willing to put in the effort and the work to attain the goal.”

Wells pushed those around him, and so did the others. “He was really so smart but thought of himself as an underachiever,” says Jenkins, his former roommate. “I would go to bed at 1:00 in the morning before a test and he would say ‘J, what

Stanley Grayson

President and COO of M.R. Beal & Co.



“FATHER BROOKS BUILT CONFIDENCE. HE MADE YOU THINK ABOUT YOUR OPTIONS.”

are you doing?’ ‘Getting some sleep.’ ‘What do you think you’ll get?’ ‘I don’t know, maybe a B.’ A white guy would say: ‘How can you settle for a B when you’re still on the table?’ ”

In the comfort of the black corridor, the men were free to be themselves. Jenkins, the star footballer whose son Julian is now defensive end with the Tampa Bay Buccaneers, was the joker. “If Eddie comes in to discuss an issue with you, he’ll be very friendly and open with an upbeat tone and a joke,” says Brooks. “He wouldn’t ever come in with a long face to tell you there was a problem.” Grayson tended to spend his Saturday afternoons immersed in a book instead of conversation. Grayson, who was the “Solomon-like one of the group”—at least the tallest, at 6-ft.-4-in.—was the keeper of the van keys. They used it to get to mixers at construction schools or visit Boston.

The enigma for many was Thomas. Jones says he was determined, even in the way he walked. Dubbed “Cous” after famed Boston Celtics player Bob Cousy because of his “mistaken view of his athletic ability,” Grayson says, Thomas was known for his loud laugh and penchant for taking the opposite side of an argument. “You would say ‘The sky is blue,’ and he would say: ‘Actually, it’s a blend of blue and gray,’” says Grayson. Thomas and Wells would go head-on on a number of issues—with Thomas often acting as the fall guy, falling in line with the rest of the school while Wells was better to challenge the rules and create something new. “He was the best theater in America,” says Jenkins.

Brooks sensed early that Thomas had come with a lot of emotional struggles. The priest spent a lot of time listening, and trying to direct him however he could. He helped find summer jobs for Thomas and his brother, Hardy, who later became a top lawyer before dying in a scuba accident. Brooks let them live in a house Holy Cross owned over the summer. He had made similar efforts

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help other black students, even scraping together extra cash for future doctor Malcolm Joseph when the young man's parents could no longer afford to pay the incidental costs of having him in school. Brooks, says Thomas, "filled these gaps in where you came from and where you were.... There were a lot of changes to absorb. Just to think about it was fatiguing. It's still really fatiguing."

The Crisis

THE EVENT that cemented the black students' bond with Brooks began on Dec. 10, 1969. Early that morning, several dozen students protesting General Electric Co.'s alleged profiteering from the Vietnam War blocked the entrance to the campus center to stop a GE recruitment drive. About five black demonstrators showed up on their own after the Black Students Union declined to support it officially. The college judicial board suspended only the organizers and the black participants, arguing that the black students were easy to identify from pictures. Wells represented the expelled black students before the board. When he and Martin complained about the selective treatment to the Reverend Raymond J. Swords, the Holy Cross president refused to reverse the decision. Almost all of the college's 65 black students decided to quit. "We were all so frightened about the consequences of quitting school," says Wells, but he adds that everyone felt they had to take a stand. "It was discriminatory and unfair."

The cost could have been profound had Brooks not stepped in. Calling the decision unjust, he tried to secure an amnesty and woo the students back. As they left campus, often to the deep dismay of their parents, Brooks worked through the nights, talking to Wells, the president, and others. "We had no money, so Father Brooks gave us a couple hundred dollars for food." Brooks argued vehemently that the administration had to back down from singling out black students for punishment. "It was racism, basically," he now says of the school's decision. Finally, after more than two days of sweaty discussions and national headlines, Swords granted amnesty. Alumni were outraged. It was Brooks who took on the task of trying to appease them while reinforcing the message that "African Americans will be at Holy Cross, whether you like it or not."

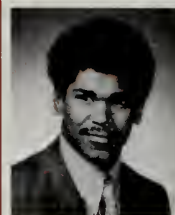
Today

AS THE YEARS PASS, the imprint of the experience these men shared at Holy Cross remains indelible. None of them is sure where he would be without having lived through it. Thomas left in 1971 to pursue his dream of getting a law degree at Yale, an experience that he considered a letdown compared with his undergraduate years. "Let me put it this way. It wasn't the kind of environment Holy Cross was," says Thomas, who



Eddie J. Jenkins

Chairman of the Massachusetts Alcoholic Beverages Control Commission



"I CAME TO SEE FATHER BROOKS AS ONE OF THE GREATEST AMBASSADORS OF JUSTICE I'VE EVER KNOWN."

characterizes Holy Cross as a B or B+ school of the time. Unlike Yale, Cross wasn't an elitist institution. Nobody excluded black students to be grateful simply for getting a foot through the door. "You don't go to college to be a decoration. You're not there to please people," he says. "I went to school to learn and grow with my life."

The rest left in the wake of some with paths cleared and others left to figure it out. Grayson's basketball dreams were dashed when he broke his leg in the middle of his senior year and lost his opportunity to be drafted. Brooks helped to see

through it. Like many of his classmates, Grayson went on to get a law degree, in part because "it took away the question about your ability." He then moved into the corporate world of politics, and finance, becoming the first African American to head the municipal bond department of a major firm (Municipal Securities). Brooks and the school "left me with a sense that I could compete," says Grayson, now president and chief operating officer of M.R. Beal & Co., an investment firm. Jenkins had his stint in the NFL before getting a law degree and pursuing a career in Boston. "We all knew where we were and where we wanted to go," he says. Jones, who was briefly homeless and stuck in less lucrative jobs, never let go of his ambitions, thanks to encouragement he got at Holy Cross. "If I hadn't gone there, I wouldn't have been a writer," he says.

Brooks wasn't a savior, nor was he even really a father figure. What he did, in Wells' view, was prove that someone at the highest level of the college deeply cared about them and their success. "Knowing that made it possible for us to remain engaged," says Thomas. "We changed the college, and it changed us."

Thomas, for one, sometimes yearns for the camaraderie of those days. "I've been focused on these jobs which consume your life," he says, pointing to a sketch that sits on the wall of his Supreme Court chambers. It shows a man draped over a desk, arms falling listlessly towards the floor. A friend captured his life. "Just exhaustion. Mental. Physical. Spiritually," Thomas explains. "You just want to slow down. You see, I take a walk, and you want to, too." One thing that makes Thomas smile is the thought of the Jesuit priest who helped him during a difficult period in his life. It wasn't serendipity; his peers went on to such successful careers, he insists. Father Brooks. ■

BusinessWeek .com

www.businessweek.com/extras

THE LEGACY CONTINUES

ONLINE: Log on to read excerpts of an exclusive interview with Supreme Court Justice Clarence Thomas, in which he reflects on racial politics, education, and other influences on his life.

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DRUG-FREE ZONE
Stapleton wants his team to be the cleanest in pro sports

T-Mobile's Unlikely Cleanup Rider

The telecom has tapped VoiceStream founder Bob Stapleton to get its team back on track

BY JACK EWING

IN THE INSULAR WORLD OF PRO cycling, Bob Stapleton stands out. For one thing, he's an American in a sport run primarily by Europeans. For another, the new chief of the T-Mobile racing team comes armed with an impressive résumé and an MBA from the University of California at Riverside—even if he doesn't yet have any Tour de France trophies.

Cycling, plagued by doping scandals and the defection of sponsors even as its popularity grows in the U.S., could use a dose of Management 101. And

few teams need more help than the one sponsored by T-Mobile, whose star rider Jan Ullrich was accused of using performance-enhancing substances on the eve of last year's Tour de France. After the avalanche of bad publicity that followed, the company considered ending its 15-year sponsorship.

Instead, T-Mobile turned to Stapleton. The 48-year-old co-founder of VoiceStream Wireless pocketed a fortune after T-Mobile's parent, Deutsche Telekom, bought his company six years ago for \$50 billion. T-Mobile executives knew and trusted the Californian, who had

served on the board of T-Mobile after the VoiceStream acquisition. It didn't hurt that Stapleton was a cycling enthusiast who had been managing Mobile's lower-profile women's team. "Bob Stapleton represented a clean break from the 'old school' cycling mentality," says Hamid Akhavan, CEO of the newly based T-Mobile International.

Stapleton's plan for the T-Mobile team, worked out during several months of 18-hour days before he officially took over the team in November, has all the marks of a classic corporate turnaround. Reposition the brand (as the team in pro sports). Find a competitive advantage (with training techniques and technology). Recruit fresh management (led by Sporting Director Rolf A. Sørensen, a respected former cyclist). Build a new fan base (by attracting new sponsors).

RAISING EYEBROWS

A KEY PART of the effort is the technology. Its bikes, custom-built by Taiwan-based Giant, are equipped with sensors that gather information on riders' condition, which is then uploaded to a central database. The system allows coaches make better decision

should take the leading role in s, and is part of a culture change leton is pushing on a team once inated by a few stars. "Merit is the s for advancement," Stapleton says. "You're ready to go, you're going to your chance in the race—not some- preordained six months earlier." the team may be the only one in pro ng where every member has mobile il to stay in touch between races. hat has really raised eyebrows in the ing world, though, is Stapleton's tolerance policy toward doping. He ntroduced a testing regime that goes beyond what the rules require, in- ing a new procedure that can detect iscule fluctuations in blood volume pinpoint previously invisible forms oping. If Stapleton's cyclists can be etitive in the three-week, 2,200- Tour de France—one of the most ing events in all of sports—it will e that athletes of any kind can win . Stapleton's efforts "will rub off on of other people," says Pat McQuaid, dent of the Swiss-based Interna- l Cycling Union, which oversees the s ProTour.

BEST RESULTS

LETON STILL has to prove that the road is the fastest road. As he readily des, the T-Mobile squad lacks a top nder following the departure of Ull- who denies doping, but announced etirement from the sport on Feb. T-Mobile's best hope is 27-year-old alian Michael Rogers, who finished n last year's Tour. "There are many e who would say you can't win ut drugs," says Stapleton. "I believe an, but it's going to take time." The

PLAYBOOK: BEST PRACTICE IDEAS

Smoother Ride

How wireless pioneer Bob Stapleton is applying business know-how to get T-Mobile's cycling team back in gear

REPOSITION THE BRAND

There's continuous drug testing and a zero-tolerance policy toward doping

RECRUIT FRESH TALENT

The sporting director and nearly half the riders are new this year

FIND A COMPETITIVE EDGE

T-Mobile's riders use training techniques never before used in cycling

USE NOVEL TECHNOLOGIES

Bike sensors and software continuously track riders' fitness

DEVELOP NEW REVENUES

The team has new sponsors and is selling more jerseys and other souvenirs

early results are modest: Rogers finished seventh in February's Tour of California, though Stapleton was heartened when Gerald Ciolek, a 20-year-old T-Mobile rookie, came within millimeters of a stage win.

To prove the doubters wrong, Stapleton dispatched the team to a seaside resort on the Spanish island of Mallorca in January. There, T-Mobile's riders were subjected to exquisite torture, such as

piling into the hotel's uncomfortably cold pool, where they stood shivering in waist-deep water, singing *Happy Birthday* to a teammate. The point? After a hot day of racing, the riders should soak in a swimming pool or a cold bath to speed recovery time. Stapleton, watching from poolside, looked pleased. "The benefits are well proven," he said.

At the resort, riders also had to participate in early morning drills, led by fitness consultants from Tempe (Ariz.)-based Athletes' Performance. The idea is to develop muscles in the hips, torso, and shoulders that cyclists tend to neglect. The National Football League uses the same methods, but they are untested in pro cycling. There's even a team shrink, in line with Stapleton's belief that being mentally fit is key to victory in cycling. "Bob is trying to give riders everything they can use to win," says Aaron Olsen, a 29-year-old Oregon native who joined the men's team this year in part because he heard good things about Stapleton.

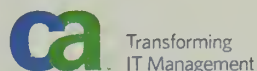
In the final analysis, winning is crucial to building revenue for the team. T-Mobile was once among the best-financed teams in cycling, but after Deutsche Telekom slashed the budget, it now operates on something north of \$13 million a year, or just a little more than the average for pro cycling. Stapleton plans to boost revenue by selling more team merchandise such as jerseys, and in a bid to attract American sponsors, the team is entering four U.S. races this year. "My goal," says Stapleton, "is to build this into a major sports franchise." ■

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affè's sales grew, so did its IT environment—but not its IT budget. CA software solutions enabled illycaffè to accommodate this by unifying the assets it already had. Automated processes boost productivity while managing costs. Operational efficiency is achieved without adding staff. And illycaffè gets maximum business value from its IT investment—which keeps the espresso flowing the world 24/7. Learn how CA software solutions enable enterprises like illycaffè to realize the power of IT at ca.com/customers.





COOL DISPLAY
TEDsters
schmooze
while observ-
ing jellyfish

Forget Davos. I'm Booked Up for TED

The Monterey thinkfest has become Silicon Valley's—and Tinseltown's—place to be seen

BY JESSI HEMPEL

LONG BEFORE GOOGLE bought YouTube and iTunes began hawking *Grey's Anatomy* episodes, Silicon Valley was trading secret handshakes with Hollywood at an exclusive gathering on the California coast. Beginning in 1984, high-rolling techies mixed with entertainers and others to trade big ideas at the TED (technology, entertainment, and design) conference, held in recent years in Monterey. The Apple Macintosh was first unveiled during TED. *Wired* magazine received its first seed money there. And last year Google used the occasion to appoint Larry Brilliant head of its billion-dollar charitable arm, Google.org.

But lately, feeding off the second Internet boom, TED has climbed into the celebrity-circuit stratosphere. The demand to get in rivals such gatherings as the Allen & Company Sun Valley conference, the World Economic Forum in Davos, and the Clinton Global Initiative in New York City. Nearly 1,000 TEDsters paid \$4,400 to attend this year's three-and-a-half-day, invitation-only festivities, which begin on Mar. 7. And openings for next year's conference sold out in mid-February, just 10 days after registration opened, even after the price of entry was bumped to \$6,000.

Author/technologist Chris Anderson, 50, who used his charitable foundation to buy the conference in 2000, is harnessing this momentum to turn TED into a global brand. TED has launched a \$100,000 humanitarian prize and now runs a bi-annual global conference as well, which will take place in Arusha, Tanzania. This summer, Anderson started free Webcasts of past sessions, called TED Talks.

What draws the A-list to TED, of course, is the chance to rub elbows with and be considered part of an eclectic crowd of thinkers. In one session of

this year's conference named "I Dream," war photographer James Nachtwey, biologist E.O. Wilson, former president Bill Clinton, and singer Paul McCartney will each deliver 18-minute presentations on topics of their choosing. In an event entitled "Exploration and Awe," the musical group They Might Be Giants is up with Virgin Group founder Richard Branson, cave explorer Bill Stone, and neurologist Vilayanur Ramachandran.

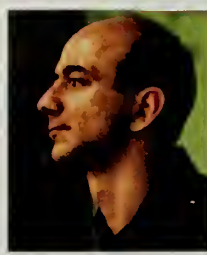
TED is a place where "you meet people who are smarter than you are," says Max Levchin, who founded the Web-payment service at 23. Lend. A highlight came three years ago when he bumped into Matt Groening, creator of *The Simpsons*, while sipping free bucks at the conference. "I would have said, this is the greatest moment of my life," Levchin says. "But then I went around and immediately met Crutcher," mapper of the human genome.

In recent years, the conference has added a strong humanitarian focus. It will mark the third year for the TED Prizes, which grant money and recognition to three social entrepreneurs to pursue a dream of their choosing. Past winners have included Bono, who used the platform to build a community of African American activists for Africa. Anderson won this year, along with Nachtwey and Wilson. As in the past, when winners announce their plans, checkbooks vied to augment the gift and people wanted to volunteer their services.

All this do-goodism is a stretch for the conference's roots. Some TEDsters find it a bit disingenuous. A few prominent tech geeks have come in recent years. "I don't think 'we are the world' line is relevant to a discussion of good ideas," says Chris Schrage, co-director of the MIT Media Lab, who no longer attends. "It feels like they were trying to get Jolie to schedule it in on her way out from Davos." ■



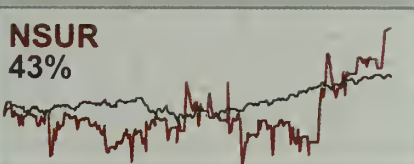
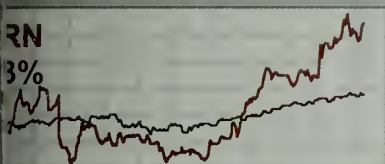
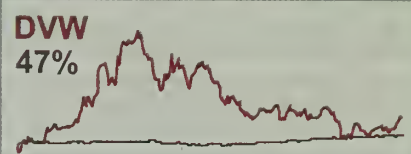
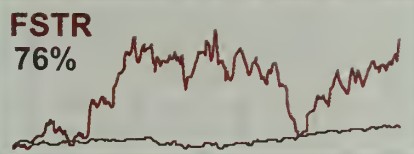
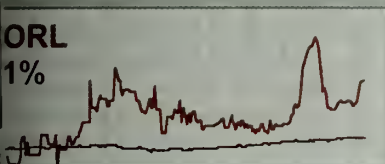
THE A-LIST At the 2006 conference (clockwise from upper left): musician Peter Dinklage, TED organizer Chris Anderson, and Amazon.com's CEO Jeff Bezos



6 TOP COMPANIES: AVERAGE 55% RETURN

Equity Investor's Micro-Cap Review

The Micro-Cap companies featured on this page were among America's top domestically traded companies with market capitalizations from \$20 million to \$500 million, in terms of 12-month share price performance for the period ending 12/31/06. While past performance is never a guarantee of future results, these six companies present investment opportunities worthy of any Micro-Cap investor's close consideration.



12 Month Share Price Performance for period ending 12/31/06

● Stock

● S&P500

ORL Auto Parts, Inc.

Symbol: SORL (Nasdaq)
Industry: Auto Parts Manufacturing
IR Contact: Christopher Chu
chu@hfgcg.com

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MARKET CAPITALIZATION: \$171.8 mil.
2006 9 MONTHS REV. GROWTH: 32.8%
2006 9 MONTHS NET INC. GROWTH: 31.2%
2006 9 MONTHS RET. ON EQUITY: 25.4%
2006 9 MONTHS EPS: \$0.43

Friendly Ice Cream Corporation

Symbol: FRN (AMEX)
Industry: Restaurant
IR Contact: Deborah Burns
debbie.burns@friendly.com

Friendly Ice Cream is a restaurant company serving signature sandwiches, entrees and ice cream in a family environment in over 520 company and franchised restaurants primarily in the Northeast. We also manufacture ice cream, which is distributed in over 4,000 supermarkets and other retail locations.



MARKET CAPITALIZATION: \$98.5 mil.
COMPARABLE SALES: 1.4% (YTD Q3)
EPS GROWTH: 62.2% (YTD Q3)
YEAR AUV GROWTH: 20.3%
YEAR REDUCTION IN DEBT: 19.7%

L.B. Foster Company

Symbol: FSTR (Nasdaq)
Industry: Transportation Infrastructure
IR Contact: David Russo
Investors@lbfoerco.com

Recognized as an industry leader, L.B. **LBFoster** manufactures and distributes quality rail, construction and tubular products necessary to build and maintain our nation's infrastructure. Founded in 1902, the Company provides superior products and services to its customers and sustainable growth to its shareholders.

- MARKET CAPITALIZATION: \$273 mil.
- SALES GR. RATE (3 YR CAGR): 17.7%
- PRETAX INC. GR. RATE (3 YR CAGR): 61.6%
- RETURN ON EQUITY: 13.8%
- PRETAX INC. CONT. OPS. % SALES: 4.1%

Insure.com, Inc.

Symbol: NSUR (Nasdaq)
Industry: Internet Insurance Brokerage
IR Contact: Phil Perillo
phil@insure.com

Insure.com is an independent, Internet-oriented insurance brokerage that caters to self-directed insurance shoppers. Founded in 1984, the Company generates revenues from the receipt of commissions on life insurance sold as well as fee revenue from the sale of non-life insurance web site leads.



- MARKET CAPITALIZATION: \$31 mil.
- CASH AND SECURITIES: \$8.2 mil.
- DEBT: \$0
- BOOK VALUE PER SHARE: \$2.67
- 2006 REVENUES: \$17.2 mil.

Covad Communications

Symbol: DVW (AMEX)
Industry: Telecommunications
IR Contact: Robert Dougherty
rdougher@covad.com

Covad is a leading nationwide provider of integrated communications, owning the largest next-generation data, voice and fixed wireless network. Services are currently available in 44 states, passing more than 57 million homes and businesses, representing over 50 percent of all US homes and businesses.



- MARKET CAPITALIZATION: \$408 mil.
- ANNUAL GROWTH PROD. INCR.: 48%
- ANNUAL RETAIL REVENUE INCR.: 26%
- 2006 A-EBITDA: \$39.6 mil.
- Q4 '06 CASH FLOW FROM OPS: \$8 mil.

INX Inc.

Symbol: INXI (Nasdaq)
Industry: Communications
IR Contact: Brian Fontana
Brian.fontana@inx.com

INX provides end to end IP communication solutions for enterprise organizations including corporations, public schools, federal, state and local governmental agencies. INX's services include advanced technology solutions supporting IP network infrastructure and VoIP implementations.



- MARKET CAPITALIZATION: \$65.0 mil.
- RAPID REV. GR. WITH 3 YR CAGR: 53%
- Q4 FY06 REV. GR. 91% OVER PRIOR YR.
- IP COM. IS A MULTI-BIL. GR. INDUSTRY
- ENT. VOIP EXP. TO GROW 25+% PER YEAR

eBay's Bid for Celebrity Cachet

How it's trying to raise its style profile to fend off online shopping rivals

BY LOUISE LEE

FOUR DAYS BEFORE THE Oscars, Constance White was buzzing around a suite at the Four Seasons hotel in Beverly Hills, surrounded by racks of designer dresses and killer

heels. White looked for all the world like a designer hoping to land her creations on the red carpet. In fact, all the items were plucked from eBay, where White is the style director, charged on this day with convincing Hollywood stylists that their celebrity clients would look fab in togs from the online marketplace. Like a red vintage dress from Azzedine Alaïa. "I'd love to get that onto Jessica Biel," says White.

Alas, no eBay clothes appeared at the Oscar ceremony (although actress Marlee Matlin did wear a silk Chloe cocktail dress from the site to Elton John's AIDS awareness fund-raiser afterward, the company says). White is undeterred. Her mission: to raise the profile of eBay Inc.'s fashion business, which it flogs on both its traditional auction site and its year-old eBay Express site, where individuals and mom-and-pop retailers sell mostly new items for a set price.

Already, eBay's apparel site draws an audience larger than those of competing sites, including Victoria's Secret and Lands' End, according to researcher

Nielsen//NetRatings. But the site is under pressure to boost its offerings of new and higher-priced goods to fend off competitors, particularly Google Inc., that are turning up the heat in the shopping and auction businesses.

In 2006, eBay's revenue from its core auction and shopping units grew 24%, to \$4.2 billion—helping place the company at No. 37 in the *BusinessWeek* 50 ranking of best-performing companies. That increase was off from the 36% rate the previous year, though,



Style director Constance White seeks designers who will sell on the site



and the value of clothing sold on the site also grew at a slower pace.

As she works tirelessly to raise eBay's fashion quotient, White "brings credibility to eBay," says North American head Bill Cobb. A former *New York Times* style reporter and *Elle* magazine editor who joined eBay in 2003, she is a regular at runway shows, hunting down designers willing to sell their creations on the company's site, if only for a short time. In 2004, White homed in on Proenza

Schouler, a fledgling brand that starting to crop up in fashion mag spreads. In the deal, the label of more than 100 items exclusively on eBay's auction site for 10 days. All the items received bids, and sold, for a total of \$7,127. "It's all building buzz among fashion influencers," says White.

White snagged a handful of designers, including Stephen Burrows and Douglas Hannant—favorites among New York socialites—to provide dresses for eBay's pre-Oscar show at the Four Seasons.

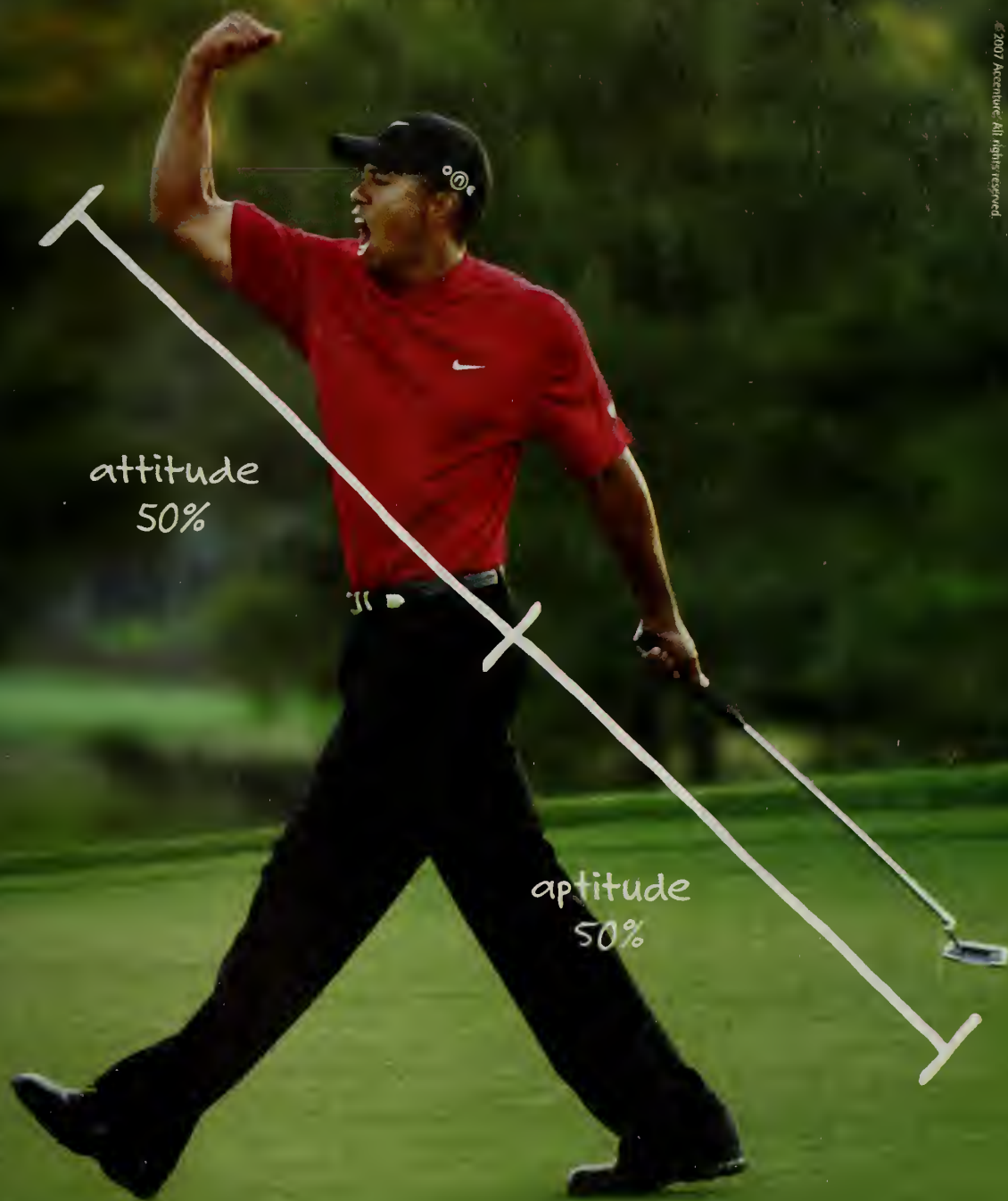
Brands, like many high-labels, aim to get in front of regular shoppers who probably wouldn't buy their gowns but might spruce up some less-expensive acquisitions. "The value of our relationship with eBay is about exponential," says John R. Miller, managing director of the Stephen Burrows brand. For the Oscar ceremony, eBay is keeping clothes, hoping to get them onto celebrities down the road.

The eBay strategy is similar to discount Target Corp., which has the slogan "Design for All" casts it as a purveyor of chic clothes and accessories. That strategy buffers Target's image, setting it apart from other discounters. But some observers think that eBay can ever build substantial following among fashionistas. "That's a stretch," says Forrester's search Inc. analyst Susan Mulpuru. "eBay is helping by its image of being a

site for used items. That's why it's downing its efforts to be aspirational.

Indeed, most eBay users are far more likely to buy or sell \$40 Liz Claiborne bags than \$1,000 dresses. So not surprisingly, the bulk of White's work is aimed squarely at Middle America. She frequently appears on the *Today* show, recently offering suggestions for how to spruce up a tired-looking wardrobe (think new shoes and maybe a trench coat) and how teen girls can dress to look trendy, but not trashy, by looking on eBay.

White also pens a blog on the site giving practical clothing tips for real-world scenarios such as "what to wear to the parents." Among the advice is to find a middle ground between wearing a "wallflower." It isn't a bad description of where eBay would like to be. ■



attitude
50%

aptitude
50%

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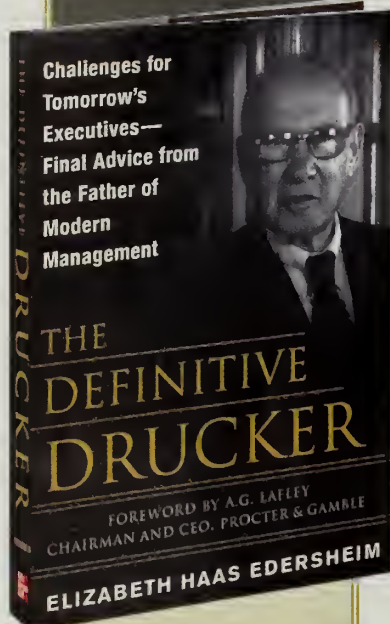
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Burrito Buzz— And So Few Ads

How Chipotle keeps sales climbing with a minuscule marketing budget

BY MICHAEL ARNDT

IT IS DEEP-FREEZER COLD OUTSIDE—just 5 degrees—and the snow is coming down hard. Never mind. Trey Parrott has just trudged up Chicago's Michigan Avenue to Chipotle Mexican Grill for lunch.

Parrott, 25, figures he has eaten at Chipotle every week since a friend first took him to one seven years ago, when he was a high school senior in Kansas City, Mo. Over that stretch, he has also reversed roles: Today he has brought along a couple of co-workers who've never been in a Chipotle before. Their snap review? Two thumbs-up.

Most fast-food chains drum up traffic by barraging consumers with mass-media ads, trumpeting their newest product or latest deal. Chipotle Mexican Grill Inc. plays by different rules. The Denver-based company eschews TV commercials and most other traditional advertising. In fact, it spends less in a year on advertising than McDonald's Corp., its former parent, spends in 48 hours. "Advertising," declares M. Steven Ells, Chipotle's founder and chief executive, "is not believable." Instead, Chipotle banks on customers to spread the word. And like Parrott, who

works for Citigroup's Primerica Financial Services, they routinely do.

This all-volunteer army has made Chipotle one of the hottest upstarts in the restaurant industry. Last year, store sales jumped 13.7% in 2006, the ninth straight year of double-digit increases. The 573-unit chain ranked among quick-serve Mexican places in a just-published national survey of consumers and tied for fourth out of 10 brands overall. Chipotle can attribute about the biggest bang of any initial public offering in 2006: Its share price nearly tripled, to 60, since January, when McDonald's began its IPO, which was completed last October.

Fittingly, Chipotle is also generating buzz for word-of-mouth marketing. These days the typical consumer is posed to so many paid pitches—estimated to range from 600 to 3,000 a day—that people tend to tune them out. People dismiss almost anything that comes from big companies, notes Dan Burstein, senior vice-president of Denuo, a media consulting division of Omnicom Groupe. But if people hear the message from a friend or even a stranger, he adds, they'll probably believe it.

poster has nothing to gain. "Chipotle has got it nailed," Buczaczer says. "I have people evangelizing the brand because they love it."

What advertising Chipotle does is not on billboards or radio, touting simple size or fresh ingredients of burritos and tacos, though with a touch of irony. But its marketing budget is minimal. Over the first 11 months of 2007, McDonald's spent \$818.9 million on traditional media advertising in the U.S., while Yum! Brand Inc.'s Taco Bell spent \$252.4 million, according to Nielsen Monitor-Plus. Chipotle's ad spend over the same span: \$4.5 million. Put another way, Chipotle spent less than 1% of its full-year revenue of \$1.9 billion on ads vs. 4% or more by its major rivals.

The thriftiness goes back to Chipotle's founding in 1993, when Ells opened a cramped eatery in a Denver storefront. With only \$100,000 to cover everything, he recalls, a single ad seemed too costly. But Ells, a white-tablecloth chef who studied at the Culinary Institute of America, thought customers should be swayed

first and foremost by the food. So instead of telling people about Chipotle's burritos, he gave them away. When dozens of reporters were camped out in Denver in 1997 as Timothy J. McVeigh was tried for the 1995 Oklahoma City bombing, Chipotle regularly delivered free food to the courthouse.

The handouts are now part of Chipotle's strategy. When Chipotle came to midtown Manhattan last July, it gave burritos away to 6,000 people, some of whom stood in line for two hours. The stunt cost \$35,000,

as James W. Adams, Chipotle's marketing director. In return, the company had 6,000 new spokespeople. "You don't spend that same amount on an ad in the *New York Times* and you wouldn't get that many people talking about the food," Adams points out. "The response to the food is almost always positive. It's delicious and it's tasty." But don't just take his word for it; any Chipotle regular would probably say the same thing. ■

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NOVATIONS

Sharper X-rays and safer shrimp

To produce X-rays bright enough to reveal the details of bones, X-ray machines expose patients to a scattered radiation, light from a bulb. Now scientists at the University of Colorado at Boulder have developed a low-cost, tabletop device that produces focused X-rays similar to laser light. In an advance, reported in *Physical Review Letters*, the device could lower radiation exposure for non-targeted areas of the body. What's more, a narrow, more intense X-ray beam has the potential to improve the resolution of X-ray images by 10 times or more.

For those with shellfish allergies, even a tiny taste of shrimp can trigger nausea, hives, breathing troubles, and more. Relief may be in sight. A research group at the University of China in Nanjing has found that by using a combination of ultrasound and radiation—methods already used for food sterilization—the number of allergy-causing proteins can be sharply reduced. In other studies, gene modification might not be needed to make hypoallergenic shrimp, lobster, and other seafood, says the report in *Food & Biotechnology*.



ENERGY NATURAL GAS IN THE COB

WHEN COOKED into ethanol, corn kernels are a source of clean, green fuel. Now, the fibrous cobs left over after harvest may help solve another energy challenge: how to improve the storage of natural gas, and let more cars and trucks use the fuel as an alternative to dirtier, more costly diesel or gasoline.

Researchers at the University of Missouri-Columbia (UMC) and Midwest Research Institute in Kansas City used cobs as a raw material to create high-

density carbon briquettes. Riddled with ultrathin tunnels that attract and hold gas molecules, the briquettes can store natural gas at record densities and under relatively low pressure. Tanks filled with these briquettes would be lighter and cheaper to make, and could store more fuel than the clunky cylinders found in today's natural gas vehicles. "Natural gas can become a real alternative," says UMC physics professor Peter Pfeifer.

CLIMATE CHANGE SAVING THE EARTH FOR JUST PEANUTS

AS EVIDENCE for global warming mounts, the debate over climate change has shifted to the price tag for reducing greenhouse gas emissions. The White House and other opponents of mandatory curbs say reductions would cripple the economy. But a new analysis from Swedish utility Vattenfall with help from McKinsey suggests otherwise. "The cost is so low, the world would hardly notice," says Vattenfall CEO

Lars Josefsson, an adviser to the German government.

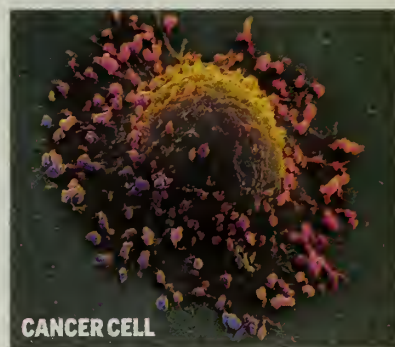
The world must slash CO₂ emissions by 27 billion tons by 2030 to keep overall warming to 2C, Vattenfall says. Five billion can come from steps—such as more insulation, higher mileage vehicles, and low energy lightbulbs—that also save money. The rest can come from cellulosic ethanol, solar and wind power, carbon capture at coal plants, nukes, and other approaches—all at a cost below \$53 per ton of CO₂. The bill in 2030 would be about 0.6% of global gross domestic product. "For the first time, we know what to do," says Josefsson.

—John Carey

CANCER TESTING A SINGLE BREATH

LAST YEAR, lung cancer's worldwide death toll hit nearly 2 million. The disease can be treatable, but many people die because it is diagnosed too late. Scientists at the Cleveland Clinic say they have made significant progress with an experimental device that can sniff out lung cancer based on a single exhaled breath. And the test may be sensitive enough to spot tumors long before symptoms appear.

When cancer cells begin to form, they trigger changes in the body's production and use of chemicals called volatile organic compounds (VOCs).



CANCER CELL

Cleveland Clinic's device uses an array of sensors that turn characteristic colors in the presence of VOCs. The research team developed the technique by chemically analyzing the exhalations of patients with different respiratory diseases and comparing them with the breath of healthy people.

The results have proven moderately accurate in tests involving more than 100 people. The next step is to refine the technique and then test it in large populations of patients. —Arlene Weintraub

An Italy Less Traveled

Matera offers ancient ambience—and food that would make Mario Batali weep

BY AMY CORTESE

YOU MAY NOT have heard of Matera, a hilltop town in remote southern Italy, but you may recognize it. With its whitewashed tumble of cave dwellings and Jerusalem-like ambience, Matera has long been the go-to place for filmmakers in search of the perfect Biblical backdrop. At least two dozen movies have been shot there, including Mel Gibson's *Passion of the Christ* and last year's *The Nativity Story*.

Only recently, though, have travelers begun to discover the region's charms. Located in Basilicata, the "instep" of Italy's boot, Matera is fast becoming a hip destination known for its stark beauty, boutique hotels, and Troglodyte Chic. Hey, it's not everywhere you can party in a four-star cave.

To appreciate Matera, you need to understand its often tragic past. The old quarter, known as the Sassi (Italian for stones), is ancient. More than 10,000 years ago, people were using its natural cave formations for shelter. Later they carved bigger cave homes and churches out of the soft tufa stone. Excess stone was fashioned into blocks and used to build facades and towers. The result is a stunning vision, a sort of Cubist fantasy.

In the early 20th century, however, the



Sassi fell into poverty and neglect. When political activist Carlo Levi wrote about it in 1945, the Sassi became known as the "Shame of Italy," and Italian authorities relocated its residents en masse to modern housing. For decades thereafter, the Sassi lay abandoned. It was only after its designation as a UNESCO World Heritage site in 1993 that the government encouraged people to move back. Since then they've been renovating homes and opening startlingly good restaurants and luxury hotels in its grottoes.

The area's first four-star hotel, the Hotel Sant'Angelo, opened three years ago. The rooms are tastefully, if minimally, furnished. Undulating stone walls

and hushed coolness envelop guests in. At \$120 for a double, breakfast included, it's hard to beat (www.santangelosassi.it).

BRING COMFY SHOES

IN THE SPRING the Palazzo C plans to open its doors in the heart of the Sassi. The renovated 14th-century palazzo will have 20 rooms, many with terraces, and a spa complete with pools built into the old cisterns that use collected water. The intimate five-room suite L'hotel in Pietra is also scheduled to open soon (www.hotelinpietra.it).

The only way to experience the



TIME MACHINE (photos, clockwise from left) A room at the four-star Hotel Sant'Angelo; a local "rock church" and a church fresco; a bird's-eye view of the city of Matera



Sassi an otherworldly aura. Notes from pianos, oboes, and a lone clarinet (thanks to a local music school) bounce softly off of the stone buildings and down cobbled lanes, the perfect accompaniment for a stroll to dinner.

You may find yourself counting the hours between meals. It seems any hole in the wall (literally) delivers a transporting culinary experience in this town. Matera is in the heart of Italy's bread basket, and the local pasta is sublimely silky. At Ristorante Baccanti, ribbons of homemade pasta were served with a delicate *cinghiale* (wild boar) sauce that would make Mario Batali weep. The restaurant's amoeba-like interior forms intimate dining grottoes dimly lit by low-hanging lamps.

Other eateries, such as Il Ristorante Le Botteghe, serve rustic local specialties made from delicious sausage, cheese, and hot peppers, along with bread native to the region. The wine of choice is local—Aglianico del Vulture, a voluptuous red that is easily one of Italy's least-noted great wines.

Despite its newfound luster, Matera is unlikely to be overrun with tourists. The nearest airport or stop on the national railway network is an hour's drive away in Bari, itself a remote outpost on the Adriatic Coast. Only the most intrepid travelers will make the journey. For those who have fallen under its spell, that's just fine. ■

Its two main neighborhoods, the Sassi Barisano and the more primitive Sassi Caveoso, cling to the sides of steep hills. To get a good sense of the place without getting hopelessly lost in its maze of alleys, hire an English-speaking guide. Three hours runs about \$50 to \$60. Dozens of *chiese rupestri*, or rock churches, mark centuries of Christian history with fading Byzantine and Latin frescoes.

To grasp what Sassi life was like before modern amenities, don't miss the Caveoso home, restored to how it looked in the 1930s. A narrated tour explains that parents typically slept in a tall bed, with chickens underneath and the horse

or donkey a few feet away. Children slept in the back on feed straw.

A short hike across a dramatic ravine takes you to the site of Jesus' crucifixion, at least as Mel Gibson's film imagined it, overlooking the Sassi. Here are the oldest grottoes, used thousands of years ago by nomads. In the spring the hills bloom with a riot of flowers. If you want to explore farther afield, local tour agencies can arrange bike trips along Basilicata's mostly empty roads (www.bikebasilicata.it).

It is in the evening, though, that Matera is at its most magical. Nightfall seems to release light, as if it had somehow been stored by the stone, giving the



Welsh and Proud

The first distillery to open in Wales in over a century turns out a smart single malt, indeed. **BY DAVID KILEY**

When it comes to whiskey, especially single-malt, the taste, finish, color, and nose are crucial, just as with wine. But as any Welshman will tell you, a good story behind the glass doesn't hurt either.

Whiskey flows like poetry out of Scotland and Ireland, but until recently Wales hadn't had a legitimate distillery in over a century. Blame the Methodists, who closed Wales' pubs on Sunday in the 1880s and read out the names of distillery workers from the pulpit until the last copper pots were pounded into scrap.

Those days are over. Welsh Whiskey Co. (some countries use the "e," some don't) began selling Penderyn single-malt whiskey in England in 2004 and in the U.S. last year. It has been well worth the wait.

Scotch whiskey must be distilled twice to be called Scotch, and genuine Irish whiskey must be distilled thrice. Four times seemed like overkill to Penderyn's founders, so they went for just one distillation. But they chose a newly devised method from a design team led by the University of Surrey's David Faraday, a direct descendant of the famous 19th century physicist Michael Faraday. The resulting

distillate has a higher alcohol content—980% for Scotch—that the firm says retains barley flavor at the outset than its competitors.

The distillery is located in the village of Penderyn, in the southern reaches of the Brecon Beacons National Park. The water used in the whisky is pumped from a spring under the distillery. The barley-wash mash that gets distilled comes from Brains Brewery in nearby Cardiff.

It's a delightful comeback story, but the whisky still has to be good. And it is. It goes through four years of aging in barrels that once

held bourbon and six months of aging in Madeira casks. Penderyn's taste is cleaner and slightly more mineral than its competitors from the north and west. The undercurrent of no doubt helped by the Malaga finishing, are closer to toffee, fruit, and light wood, with a touch of spice. Its lightness makes it a good choice for drinking straight up.

Single-malt sales have been climbing for the past decade.

Established distillers of both single-malt and blended whiskies have been creating a dizzying array of versions to justify higher prices and satisfy demanding palates. Penderyn, available in 1.75-liter bottles for about \$70 per bottle, has an advantage: It's truly one of a kind, complete with a history that only a Welshman could properly teach. ■

Penderyn stands up to fine Scotch—and it has a unique story

Premium Batches

Crown Royal XR, \$150

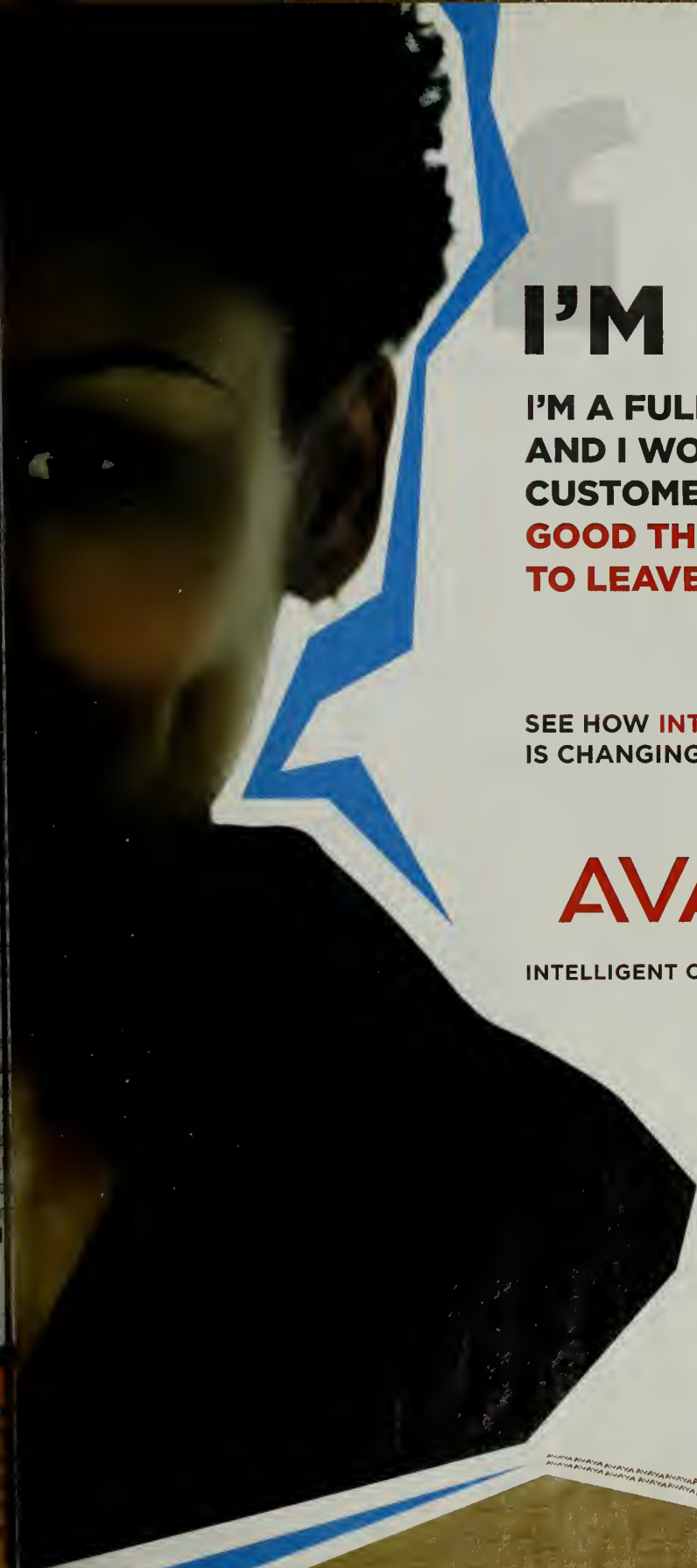
This limited Canadian whisky is blended from the last remaining whiskies from Crown Royal's now-closed Waterloo (Ont.) distillery. It is creamy and full-bodied with hints of vanilla, toffee, and spice. But it also tastes overly wooded and lacks the refinement and character one expects at this price.

Bushmills 21-Year-Old Irish Whiskey, \$115

This single-malt whiskey is aged in three different vessels: American bourbon barrels, Spanish oloroso sherry casks, and Madeira drums. The Madeira leaves hints of raisins, toffee, and almonds. It's now a sought-after sip, with the 2004 release held in high regard. All told, well worth the premium price.

Johnnie Walker Blue Label Magnum, \$500 (1.75 liters)

Blue Label, which now comes in a 1.75-liter bottle, is blended from several small-batch reserve whiskies. It's complex, with myriad tastes: tobacco, allspice, maple, and pan. Blue Label is an underdog fine Scotch whisky and is at its best after it has opened up a bit in the glass and without ice.



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BY ROBERT PARKER

Classy California Cuvées for a Song

I TASTE MANY CALIFORNIA WINES that are world-class but are priced so high they cannot be considered “values.” With all the marvelous fruit grown in the Golden State, it’s a shame how few wineries turn out good, modestly priced wines. Here are some perennial best buys, which include chardonnay, zinfandel, and some wonderful red blends.

Beringer 2005 Alluvium Blanc Knight’s Valley 90 points
Beringer 2005

Chardonnay Napa Valley 86 points
These two whites from this huge operation are far superior to what their \$16 prices might suggest. The Alluvium Blanc, a crisp blend of sauvignon blanc and sémillon, is filled with fig and grapefruit characteristics. It is Beringer’s take on a dry white Bordeaux. The Napa chardonnay offers plenty of honeysuckle, pear, and tropical fruit notes.

Edmeades 2004 Mendocino Zinfandel 87 points
Edmeades 2005 Mendocino Zinfandel 89 points

This producer, working in the northern Mendocino frontier, has long created zinfandels of great character. While the single-vineyard zins are expensive, the basic cuvée, at \$18, is always a strong effort that reveals plenty of this varietal’s black pepper, sweet-and-sour cherry, and herbal notes.

Gallo Family Vineyards 2004 Chardonnay Sonoma Reserve 90 points

Gallo Family Vineyards 2005 Pinot Gris Sonoma Reserve 88 points
The Gallo winemaking empire is putting out better and better wines, and these are among the best values in the lineup. The gorgeous 2005 pinot gris, at \$13, is a food-friendly crisp and fruity white. The refreshing 2004 chardonnay, also \$13, reveals classic aromas of lemon butter, white peaches, and honeysuckle with little evidence of oak.



Kendall-Jackson 2005 Vintner’s Reserve Chardonnay Jackson Estates 89 points

At \$12, this may be the best value in American chardonnay. Moreover, you will have no trouble finding it. K-J produces hundreds of thousands of cases of this wonderful cuvée, which emphasizes fruit instead of wood.

Marietta Non-Vintage Old Vine Red Lot No. 41 89 points

You need not pay attention to the lot number. I have tasted every one since the early teens, and the wine’s uniformity is always something to behold. This \$10 offering has plenty of pepper, earth, and spice. Enjoy it with barbecue foods and pizza. It is puzzling why

few California wineries try to emulate this great success.

Château St. Jean 2005 Fumé Blanc Sonoma 85 points
Château St. Jean 2005 Pinot Blanc Alexander Valley 88 points

Where else can you find beautiful, smoky, crisp, dry white for \$13? The Fumé blanc is a perfect match for seafood and poultry. If you enjoy the taste of orange marmalade or fresh, ripe apples, check out the 2005 pinot blanc, which sells

Trentadue 2005 Old Vine Red Sonoma 87 points

Medium-bodied and fruity, at \$14 it is an ideal bistro wine. This California version of a Côtes du Rhône reveals scents of strawberries, cherries, earth, and pepper. The name refers to a patch of old vine planted with different grapes as opposed to a single varietal. ■

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(TOP) JEROME REY/LA PROVENCE; THOMAS KUHLENBECK

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The Artful Investor

New research
calls art a smart
investment, but
skeptics point to
high costs and
high risk

**BY CHRISTOPHER
PALMERI**



OLAF HANKE

JOHN MORRISSEY HUNTS young artists the way some money managers dig for undiscovered stocks. In the evenings the West Palm Beach (Fla.) attorney scours magazines such as *Artforum* and Web sites such as Artnet. He tours galleries in New York and Miami, chatting up dealers and sometimes the artists themselves. Buying works early can lead to spectacular returns. In 1998 he bought a piece by abstract painter Cecily Brown for \$11,000 at her second show, at New Deitch Projects, a gallery. Last year, he says, a similarly sized work from the same show sold at auction for \$968,000. "My artists outperformed any other investment I've made," he says. Art is the record price for a single painting was broken three times last

The auction houses Christie's, Sotheby's, and Phillips de Pury sold a combined \$1 billion worth of contemporary art last fall. Attendance continues to grow at art fairs such as December's Art Basel Miami Beach and February's Art Show in New York. The explanation is that a new breed of investor, the hedge fund manager rolling in money and looking to show off wealth and sophistication, has entered the scene. There is another factor at work, however: the belief that art is an asset class that belongs in your investment portfolio along with stocks, bonds, and real estate.

Leaders of this new art-as-asset class are Jianping Mei and Michael Moses, two longtime professors at New York University's Stern School of Business. In 2002 they released a study that showed art handily outperformed bonds and Treasury bills going as far back as 1900. Based on their most recent results through June of last year, Mei and Moses conclude that art narrowly edged out stocks over the past 10 years, returning 8.5% annually. Contemporary art—which they define as anything created since 1950—did even better, returning 12.7% over the past 10 years, three percentage points better than stocks.

The pair founded a consulting firm, Beautiful Asset Advisors, to sell their research to investors. Moses says that because their studies show a low correlation between the performance of art and other assets, art can be used to diversify an investment portfolio. He suggests an

allocation of roughly 10% for investors who have at least \$500,000 in financial assets, after debt. "We try to be quantitative," he says, "and get the war stories and folklore out of it."

Mei and Moses were not the first academics to examine art as an investment. Over the years dozens have done so, and their results vary widely. Most concluded that art performs poorly. In one of the most cited works, then Princeton University economist William Baumol reported in 1986 that art delivered a return of just 0.55% per year between 1652 and 1961.

Moses argues that his research is more comprehensive than past attempts. Baumol looked at just 640 sales over a 300-year period. Mei and Moses track sales in a database that now approaches 10,000 transactions. The professors only count works that have sold at least twice at one of the major auction houses. By focusing on repeat sales of the same piece, they hope to account for the fact that works, even by the same artist, aren't identical.

Other compilers of art data use different approaches. London-based Art Market Research also uses results from the big auction houses. The firm lops off the top and bottom 10% of prices under the theory that outliers unduly influence the averages. Its contemporary art index shows the category returning 8.7% over the 25 years ending in 2005, which is about four percentage points per year below the contemporary art returns from Mei and Moses. Whichever method is used to calculate returns, it's dicey for investors to count on a similar return, especially if they're buying works of un-

known or even up-and-coming artists.

Nearly all of the research into art as an investment concludes that it is riskier than stocks. In a study published last year, Merrill Lynch & Co.'s chief investment strategist Richard Bernstein found that while the probability that an investor will lose money in stocks, bonds, or real estate declines sharply the longer it is held, the chance of losing money in art remains high. Over a five-year period, an investor has a roughly 1 in 6 chance of seeing an art investment decline; for the Standard & Poor's 500-stock index, it's 1 in 10.

There are other drawbacks. It's far more difficult to get the same level of diversification in art that you would from mutual funds, which can contain hundreds of stocks. Commissions to buy or sell art at auction or through a dealer can easily top 10%, far higher than what you pay a stockbroker. Liquidity is poor. Even in hot markets, many items fail to sell at auction. There are transportation and insurance costs. If you're lucky to have long-term capital gains, art work is taxed at the full 28% rate, vs. 15% for securities. Dividends? They are limited to the enjoyment you get from looking at the work.

Over the years several entrepreneurs have tried to put together mutual-fund-like pools to make art investing easier for the small fry. Many have quietly gone out of business because they couldn't raise enough money from investors. Moses has an explanation for that. "One of art's great beauties is that it's fun to collect," he says.

"If you put money into art, you want the fun of chasing after something."

Even Moses likens the current runup in contemporary art to the dot-com bubble. After a similar period of art inflation ended in 1990, he notes, contemporary-art prices fell by 50% over the next five years. It took a decade for paintings by the likes of Keith Haring and Julian Schnabel to bounce back, according to Artnet. Baumol, who now has offices in the same building at New York University as his art research rivals Mei and Moses, remains unconvinced of art's long-term investment potential. "There are periods when art becomes fashionable and pays off," he says, "but it's not a consistently good investment." ■

Art dealers' commissions can top 10%—far more than a stockbroker's

The Bubble Guru's Take on Housing

Yale's Robert Shiller thinks the market hasn't hit bottom, but he leaves room for the human factor

MARKET BOOMS AND BUSTS fascinate Robert S. Shiller. The Yale University economist emerged from academic obscurity when *Irrational Exuberance*, which argued that the stock market had reached unsustainable heights, was published as the indexes were hitting their peaks in 2000. Shiller added a chapter on residential real estate in the 2005 edition, saying the same mania was at work. Confusion reigns over the direction of the home prices now, and Contributing Editor Christopher Farrell talked with Shiller about it.

Where are home prices headed?

Looking at our national home-price index [the Standard & Poor's/Case-Shiller Home Price Indices], it appears that the boom is over. [Prices] had been rising at an accelerating rate from the late 1990s through 2004. Since then the rate of increase has been decelerating.

We're going through a peak. There hasn't yet been a big price decline, like 20%. For instance, out of the 20 major cities in the country the biggest drops are in Detroit and Boston, which are down 5.9% and 5.1%, respectively. I think there's a good chance home prices will be down 10% to 30% over the next five years.

Developers are throwing in an SUV or granite countertops to lure buyers. Does this mean prices have fallen more than the data show?

Developers don't want to cut prices. They try to disguise [them]. The government's new-home price index doesn't take this into account. Prices for new homes are falling faster than the index says they are, but I don't know by how much.

Are low long-term mortgage rates supporting the market?

Mortgage rates have been falling for 25 years and when I look at the whole history of mortgages and home prices, I don't



see a strong relationship. The psychology is more important. In the late '70s, interest rates rose to double-digit levels, and there was still a housing boom.

Are there any signs of strength?

Yes. One part of the National Association of Builders/Wells Fargo Housing Market Index measures the traffic of prospective

buyers, and it has started to go possible that the boom could resu

We're talking about human p ch ogy. If people think home pri go up for some time, it becomes fulfilling prophecy.

What will bring the boom to an end? Bubbles don't pop suddenly. comes out gradually. More an people decide that the market is The other large factor is a big st homes.

I've been reading old newspa advertisements to see how past ended. It's usually when stor to circulate that embarrass peo believed in the boom. For examp, was a Florida land boom [in the There were stories of people buyi that was swamp. Booms end whe start to fall, and then there are st buyer stupidity that are told and sense that's happening now.

There's a lot of news about default on subprime mortgages. Will that have an effect on prices?

It could. Problems like this can market psychology. The subpri problem w much bigger really start fal

Was the recent rise in home prices the biggest housing boom in U.S. history?

In the sense was the mo vasive. We' booms befo they didn't the whole This one sta in the glamo and then it from place to

How has that affected home psychology?

People think buy a house a and get a hig

We have found that homeown very high expectations.

What kind of return should home expect over the long term?

From 1890 to 1990 home prices an average of 3% annually. Mo big gains were made after Worl and since 1998. ■

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The Trouble With ETFs

As more esoteric funds proliferate, they're failing to live up to their promises. **BY LAUREN YOUNG**

HERE WE GO AGAIN. Wall Street takes a good product, the exchange-traded fund, and in pursuit of profits creates multiple permutations.

There are now nearly 450 ETFs, 75 of which were launched this year. In their rush to market, providers are creating flawed funds. Instead of mimicking the performance of an index, plenty are missing the mark, often falling short.

New research from Morgan Stanley shows significant "tracking error" in a number of these funds. That's the difference between the ETF's return and that of the index it's supposed to replicate. It works like this: The total return for the Dow Jones Transportation Average was 9.81% last year, while the ETF that tracked it gained only 8.92%. After accounting for expenses the tracking error was 0.41 percentage points. In short, investors aren't getting all they expect.

PROBLEMS OVERSEAS

FUNDS THAT TRACK the big indexes like the Standard & Poor's 500 rarely go far astray, according to Morgan Stanley. That's because they own widely held stocks that are easy to trade. The misfires happen when ETFs try to match more esoteric indexes, like the High Growth Rate Dividend Achievers Index. These niche indexes may have big stakes in fewer stocks or hold small companies that are harder to trade. "With all of the new and innovative indexes, there are questions whether these things can be faithfully replicated," says Dan Culloton, a senior analyst at Morningstar Inc.

Foreign ETFs often veer off the track, too. The iShares S&P Latin America 40 Index Fund (table) missed its benchmark

by 1.23 percentage points last year, because the fund can't always buy locally listed shares it needs in Brazil, Argentina, and Chile. "The acceptable level of tracking error depends on the particular market," Christine Hudacko, a spokeswoman for Barclays Global Investors, the ETF provider with \$270 billion in portfolios.

Sometimes regulatory barriers affect a fund's performance. Case in point: iShares DJ US Telecommunications. It failed to match its underlying index in 2006 by nearly four percentage points, an extraordinary divergence. The problem was that AT&T, which gained 53% last year, is 46% of the index but

24% of the telecom index (Securities regulators bar a fund from investing more than one-third of its assets in a single company's stock.)

These errors don't always work against the investor. In some cases, ETFs outperformed their wide margin. iShares WilderHill Clean Energy beat its benchmark by nearly three percentage points. Investors should be pleased, but that's indexing. "The job of an ETF manager is to beat the index," says Paul Mazzilli, director of exchange-traded funds research at Morgan Stanley. "The only source of return should be the fees."

The best way to avoid errant funds is to stick to the big, plain-vanilla offerings with low expenses. The major market ETFs, and those on "styles" such as cap growth or small-cap value, run within several hundredths of a percentage point of their benchmarks. Fixed-income ETFs come close to the target, within 0.08 percentage points. Index funds are a game of inches, not miles. While you are negotiating to get exact, the point of the game is to get within a hair of the bull's-eye.



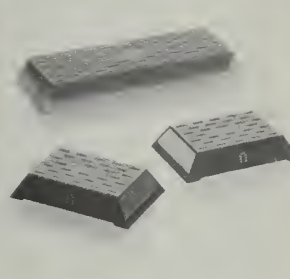
EXCHANGE-TRADED FUND/SYMBOL	2006 TRACKING ERROR*
iShares DJ US Telecommunications/IYZ	-3.98
Vanguard Energy/VDE	-1.78
PowerShares Dyn. Bldg. & Construction/PKB	-1.51
iShares S&P Latin America 40/ILF	-1.23
KBW Regional Banking/KRE	-0.64
SPDR DJ Wilshire Total Market/TMW	-0.60
PowerShares Value Line Timeliness/PIV	0.95
Vanguard Consumer Staples/VDC	1.04
PowerShares Lux Nanotech/PXN	2.09
PowerShares WilderHill Clean Energy/PBW	2.89

*Percentage points Data: Morgan Stanley

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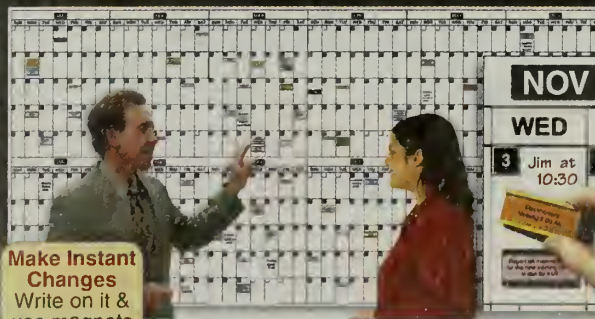
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BY GENE G. MARCIAL

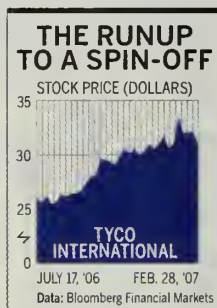
TYCO'S SUNDRY PARTS MAY BE WORTH MORE THAN THE WHOLE

BIG CUSTOMERS ARE LINING UP WITH ORDERS FOR TINY ALTAIR

SUPERGEN HAS A DEAL WITH J&J TO MARKET ITS CANCER DRUG

As Tyco Splits into Three

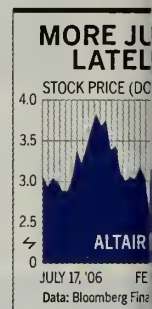
THE DECONGLOMERATION of Tyco International (TYC) planned for the spring hasn't excited investors. But some pros, who expect the stock to jump when the idea of Tyco splitting into three catches on, have been buying shares. John Maloney, president of M&R Capital Management, says a sum-of-the-parts valuation puts Tyco's worth at 40. Losing the "conglomerate discount" and being free to "fly on their own" should give impetus to the three companies, says Maloney. The stock was at 30.83 on Feb. 28, following the board's decision in early January to O.K. the split. The plan is for Tyco to spin off two units—called Healthcare (24% of sales and 38% of operating profits) and Electronics (31% and 31%, respectively)—to Tyco shareholders on a tax-free basis. Tyco International will retain the unit embracing Fire & Security and Engineered Products (together they account for 45% of sales and 31% of profits). Owning 100% of three companies is a big bonus for current shareholders, Maloney says. "Tyco trades at multiples lower than comparable companies," says Charles Ronson, an analyst at Tradition Asiel Securities. "Three-way spin-offs," he adds, "create numerous market inefficiencies." Such inefficiencies usually offer opportunities that could add value. David Bleustein of UBS, which has done banking for Tyco, rates the stock a buy. He expects Tyco will earn \$2.05 a share on revenues of \$43.5 billion in the year ending Sept. 30, 2007, vs. \$1.84 on \$41.1 billion in fiscal 2006.



Charging the Batteries At Altair

ALTAIR NANOTECHNOLOGIES (ALTI), a tiny outfit in the emerging nano market, has caught the eye of the likes of Alcoa and Eli Lilly. The big interest lately is in its rapid-charge, high-power NanoSafe battery packs. It has a three-year pact to supply its batteries to Phoenix Motorcars. One go-ahead sign: On Feb. 23, in connection with his new alternative-fuels policy, President Bush saw a demonstration of Phoenix' sport-utility truck, equipped with Altair's battery, along with four other vehicles. Altair uses nano-structured material for the negative electrode, which gives its batteries

more power. At Alcoa, Altair provides batteries for its hybrid-electric delivery vans. And at Lilly, Altair helps make compounds to reduce kidney disease in cats and dogs. John Roy of WR Hambrecht, who rates the stock, now at 3.42, a buy, says 2007 orders from Phoenix alone could run up to \$42 million. He upped his 2007 estimate from a loss on sales of \$18.8 million to a profit of 8¢ a share on \$32.9 million. Mark Harding of Maxim Group also has a buy based on Altair's pipeline



SuperGen Is Looking Healthier

BIOTECHS ARE GAINING traction this year as fund managers discover many with viable products that are still underpriced. One is SuperGen (SUPG), whose drugs target solid tumors, blood disorders, and hematologic malignancies. Now trading at 4.78, SuperGen has inked a pact with Johnson & Johnson to market its Food & Drug Administration-approved drug Dacogen—for myelodysplastic blood disorder syndrome—outside North America. To start, J&J plans to focus on Europe and Japan. In the U.S., Dacogen is marketed by MGI Pharma, which owns 9% of SuperGen. Dacogen's U.S. 2006 sales totaled \$36 million, beating even the company's estimate of \$25 million. For 2007, Dacogen sales will hit \$120 million, figures Elemer Piroos of Rodman & Renshaw, who rates the stock a buy, with a 12-month target of 24. SuperGen's own estimate is a more modest \$100 million. Its royalties from MGI will grow and expand, so Piroos expects MGI to buy SuperGen at some point. Vinny Jindal of ThinkEquity Partners also rates SuperGen a buy, but with a much lower 12-month target of 8. He expects to see an uptick in Dacogen sales in the first quarter. ■



BusinessWeek .com

ONLINE: Gene Marcial's Inside Wall Street is posted at businessweek.com investor at 5 p.m. EST on the magazine's publication day, usually Thursday. **Note:** Unless otherwise noted, neither the sources cited in Inside Wall Street nor the firms hold positions in the stocks under discussion. Similarly, they have no investment banking or other financial relationships with them.

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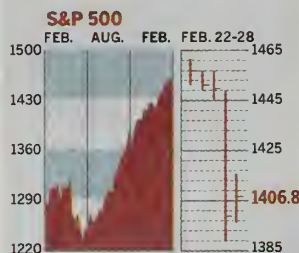


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STOCKS



COMMENTARY

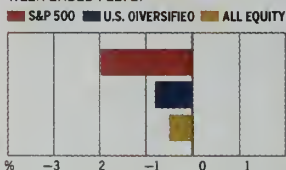
A massive sell-off on Feb. 27 wiped out all of the S&P 500's gains so far this year. Investors ran for the exits on news of weak housing and factory data, plunging foreign stock markets, remarks by former Federal Reserve Chairman Alan Greenspan about a possible recession in the U.S., and a computer glitch at Dow Jones & Co.

Data: Bloomberg Financial Markets, Reuters

MUTUAL FUNDS

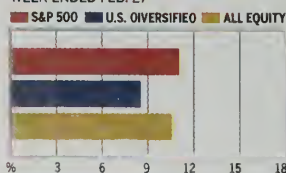
4-WEEK TOTAL RETURN

WEEK ENDED FEB. 27



52-WEEK TOTAL RETURN

WEEK ENDED FEB. 27



Data: Standard & Poor's

U.S. MARKETS

	FEB. 28	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
S&P 500	1406.8	-3.5	-0.8	9.9
Dow Jones Industrials	12,268.6	-3.7	-1.6	11.6
NASDAQ Composite	2416.2	-4.1	0.0	5.9
S&P MidCap 400	838.1	-3.3	4.2	8.3
S&P SmallCap 600	405.5	-4.0	1.4	7.6
DJ Wilshire 5000	14,213.9	-3.5	0.0	10.2

SECTORS

	FEB. 28	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
BusinessWeek 50*	790.8	-4.1	-1.0	4.5
BW Info Tech 100**	435.8	-3.5	-2.6	13.5
S&P/Citigroup Growth	644.5	-3.5	-1.2	6.4
S&P/Citigroup Value	761.2	-3.5	-0.4	13.4
S&P Energy	436.8	-2.2	-4.1	12.1
S&P Financials	482.4	-5.1	-2.6	10.4
S&P REIT	210.1	-5.0	5.6	25.6
S&P Transportation	264.3	-5.5	0.2	1.0
S&P Utilities	194.8	0.8	4.4	18.4
GSTI Internet	203.4	-3.6	1.8	5.6
PSE Technology	882.9	-3.1	0.8	1.5

*March 19, 1999=1000 **February 7, 2000=1000

GLOBAL MARKETS

	FEB. 28	WEEK	% CHANGE YEAR TO DATE
S&P Euro Plus (U.S. Dollar)	1999.6	-2.8	0.1
London (FT-SE 100)	6171.5	-2.9	-0.1
Paris (CAC 40)	5516.3	-3.1	-0.1
Frankfurt (DAX)	6715.4	-3.3	1.1
Tokyo (NIKKEI 225)	17,604.1	-1.7	2.1
Hong Kong (Hang Seng)	19,651.5	-4.8	-1.1
Toronto (S&P/TSX Composite)	13,045.0	-2.1	1.1
Mexico City (IPC)	26,639.0	-7.2	0.1

FUNDAMENTALS

	FEB. 27	WEEK AGO
S&P 500 Dividend Yield	1.83%	1.75%
S&P 500 P/E Ratio (Trailing 12 mos.)	17.0	18.0
S&P 500 P/E Ratio (Next 12 mos.)*	14.9	15.5
First Call Earnings Revision*	-1.55%	-2.62%

TECHNICAL INDICATORS

	FEB. 27	WEEK AGO
S&P 500 200-day average	1342.9	1339.9
Stocks above 200-day average	73.0%	81.0%
Options: Put/call ratio	1.09	0.80
Insiders: Vickers NYSE Sell/buy ratio	8.07	7.26

BEST-PERFORMING GROUPS

	LAST MONTH %	LAST 12 MONTHS %
Forest Products	14.5	70.0
Constr. Materials	14.4	59.1
Power & Energy Traders	13.7	55.4
Education Services	9.0	47.5
Agricultural Products	7.4	38.1

WORST-PERFORMING GROUPS

	LAST MONTH %	LAST 12 MONTHS %
Homebuilding	-11.9	Homebuilding
Spclzd. Cnsmr. Serv.	-11.5	Electric Mfg. Svcs.
Residential REIT's	-9.0	Photographic Produ.
Environmental Services	-8.9	Gold Mining
Broadcasting	-8.6	Computer Retailers

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Japan	3.7	Pacific/Asia ex-Japan	30.3
Precious Metals	3.3	Real Estate	28.3
Utilities	2.9	Latin America	26.0
Diversified Pacific/Asia	1.5	Europe	24.6
LAGGARDS		LAGGARDS	
Latin America	-2.1	Health	0.9
Financial	-2.0	Japan	1.3
Large-cap Growth	-1.7	Technology	3.1
Health	-1.7	Small-cap Growth	4.6

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
iShares Silver Trust	10.2	Dreyfus Prem. Grtr. China A	68.0
Japan Smaller Cos.	8.7	Oberweis China Opport.	55.6
iShares GSCI Comdty. Idx.	8.1	Old Mut. Clay Finlay Ch. A	54.3
WisdomTree Jpn. High-Yld. Eq.	7.6	E.I.I. Intl. Property Instl.	53.7
LAGGARDS		LAGGARDS	
Eaton Vance Greater India A	-8.7	American Heritage Grth.	-25.0
Matthews India	-6.6	SPDR Homebuilders ETF	-18.7
Quaker Btch. Pharma.-Hthcre. A	-5.8	Ameritor Security Trust	-18.2
DireXion HCM Freedom	-5.7	ProFunds Sh. RI. Est. Inv.	-18.0

INTEREST RATES

KEY RATES

	FEB. 28	WEEK AGO
Money Market Funds	4.86%	4.86%
90-Day Treasury Bills	5.14	5.17
2-Year Treasury Notes	4.63	4.84
10-Year Treasury Notes	4.56	4.65
30-Year Treasury Bonds	4.67	4.79
30-Year Fixed Mortgage †	6.05	6.14

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	10-YR. BOND
General Obligations	3.73%
Taxable Equivalent	5.33
Insured Revenue Bonds	3.94
Taxable Equivalent	5.63

THE WEEK AHEAD

NONMANUFACTURERS' INDEX

Monday, Mar. 5, 10 a.m. EST

» The Institute for Supply Management's February nonmanufacturing activity index is forecast to have fallen to 58%. That's the median prediction among economists queried by Action Economics. The January index rebounded to 59%.

FACTORY INVENTORIES

Thursday, Mar. 6, 10 a.m. EST

Manufacturing inventories probably

rose by 0.2% during January, after edging up 0.1% in December.

BEIGE BOOK Wednesday,

Mar. 7, 2 p.m. EST » The Federal Reserve releases its summary of economic conditions ahead of the Mar. 21 monetary policy meeting. Economists expect the Fed to keep interest rates at 5.25%.

INSTALLMENT CREDIT Wednesday,

Mar. 7, 3 p.m. EST » Consumers probably tacked on \$5 billion of debt in January.

EMPLOYMENT Friday, Mar. 9, 8:30

a.m. EST » Nonfarm payrolls in March are expected to have grown by 120,000 workers, after a gain of 111,000 the month before. The jobless rate probably remained at 4.6% for a second straight month.

INTERNATIONAL TRADE Friday,

Mar. 9, 8:30 a.m. EST » The January trade deficit most likely narrowed to \$59.5 billion. The December trade gap widened to \$61.2 billion.

The BusinessWeek production index improved to 293.9 for the week ended Feb. 17, an 8.8% gain year ago. Before calculation four-week moving average index fell to 293.1.

BusinessWeek .com

For the BW50, more invest data, and the components the production index visit www.businessweek.com/extras

Company Index

Index gives the starting page for a story or feature with a significant presence to a company. Most subsidiaries are indexed under their own names. Companies listed only in tables are not included.

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 Rodman & Renshaw **100**
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Getting to the Corner Office

TRUE NORTH Discover Your Authentic Leadership

By Bill George with Peter Sims; Jossey-Bass; 251pp; \$27.95

When top executives sit down to write a book, the result is often a celebratory memoir or an upbeat treatise on how you can emulate their success. Bill George has chosen to produce neither, and readers are the luckier for it. Instead, the former Medtronic CEO and current Harvard Business School professor has

teamed up with co-author Peter Sims to offer a practical, inspiring examination of the executive experience, *True North: Discover Your Authentic Leadership*. While the volume is a sequel to George's 2003 best-seller, *Authentic Leadership*, it easily stands alone as a guide to locating what the authors call "the internal compass that guides you successfully through life."

At the heart of *True North* is a series of interviews with 125 managers, from Novartis CEO Daniel Vasella to Palm co-founder Donna Dubinsky. George and Sims indulge in a few anecdotes that flatter their subjects. But they also get interviewees to talk about failures, emotional challenges, personal tragedies, regrets—in short, life events that knocked them off typical career paths. Taken together, the stories illustrate *True North*'s thesis: that there is no single way to become an ideal leader. The volume is both memorable and perceptive.

True North has three parts. The first is an anecdote-rich section that describes what it means to be an "authentic leader" and examines how various people arrived at this status or lost their way. There's Kevin Sharer, who abandoned General Electric for MCI, only to find that he was miserable and that Jack Welch wouldn't take him back. ("Hey, Kevin, forget you ever worked here," Welch told him.) Sharer learned patience and humility and went on to become chairman of Amgen. The key experience for Novartis' Vasella, in contrast, came from childhood: He endured years of illness and learned the value of compassion in health care.

The book's second section, which focuses on the five key facets of a leadership plan, is its most useful. First comes "knowing your authentic self," i.e., learning to be self-aware. This proved difficult for David Pottruck, a former CEO of Charles Schwab who found that his long workdays and aggressiveness made colleagues resent and distrust him. His answer, on the job and in his third marriage, was to force himself to seek feedback on a regular basis. Next, after you

attain a measure of self-awareness, you should focus on values and principles that matter to you. David Gerger Jon Huntsman, both of whom served in the Nixon White House and experienced the Watergate scandal up close, had to learn to draw ethical lines. Huntsman recalls the "an amoral atmosphere permeated the White House." A growing realization, highlighted by a request to entrap a politician, prompted him to leave.

A third step in the construction of a leadership plan is discovering what motivates you. The most successful of the authors learn, rarely start out wanting to get rich. They are inspired to make a difference, to test their limits, to

follow a passion. In many cases, they abandon secure posts for the unknown. Fourth in the authors' scheme is building a support team. Here, we read that many in Silicon Valley, including Palm's Dubinsky, were aided by Chairman Bill Campbell, whom George calls the "dean of mentoring." Howard Schultz of Starbucks found inspiration in management guru Warren Bennis. Finally, you should discover what George and Sims call "an internal life" that augments work with such things as family, friends, community service, exercise, church, and whatever else matters in your life.

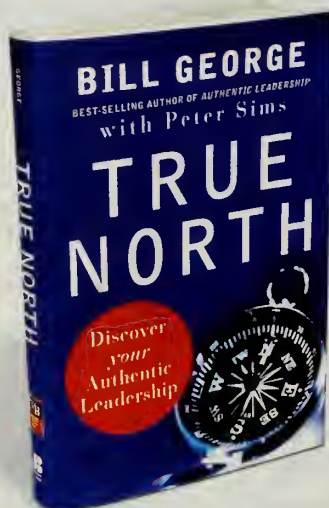
True North's last section deals with empowering the people around you. There, the authors ask leaders—including many women (mostly in any other part of the book)—to talk about the higher calling of their work. Avon Products' Andrea Jung explains that "what we do is

empowering women in the community." While Anne Mulcahy of Xerox talks about trying to motivate her personnel as the company struggled to stave off bankruptcy. As elsewhere in the book, there is no victory lap. At one point, Mulcahy recounts pulling over on a highway after a tough day, saying to herself: "I don't know where to go. I don't want to go home. There's just no place to go."

An inspiring, anecdotal guide to effective and humane leadership

Most readers will relate to at least some of the subjects' struggles, whether they're watching a sibling die or fighting to keep ego from getting in the way of results. These people come across as fallible, emotional, and, yes, authentic. A series of exercises at the end of each chapter may help readers evaluate their priorities and practices. While *True North* offers no simple answers, it provides plenty of fodder to help readers figure out for themselves how to become a leader. ■

—By Diana



The BusinessWeek Best-Seller List

HARDCOVER BUSINESS BOOKS		LAST MONTH	MONTHS ON LIST	PAPERBACK BUSINESS BOOKS		LAST MONTH	MONTHS ON LIST
JIM CRAMER'S MAD MONEY James J. Cramer with Cliff Mason (Simon & Schuster • \$25) <i>More investing wisdom from the television personality.</i>	1	2		1 START LATE, FINISH RICH David Bach (Broadway • \$14.95) <i>Strategy and tactics for baby boomers nearing the age of retirement.</i>	—	1	
THE WORLD IS FLAT Thomas L. Friedman (Farrar, Straus & Giroux • \$30) <i>Globalization is great—sort of—says a columnist for The New York Times.</i>	3	21		2 GOOD TO GREAT AND THE SOCIAL SECTORS Jim Collins (Collins • \$11.95) <i>A primer on how noncorporate organizations can excel.</i>	1	14	
FREAKONOMICS Steven D. Levitt, Stephen J. Dubner (Morrow • \$27.95) <i>Crack gangs, the Ku Klux Klan, and more.</i>	2	22		3 J.K. LASSER'S YOUR INCOME TAX 2007 The J.K. Lasser Institute (Wiley • \$17.95) <i>Time to start sorting receipts.</i>	3	2	
JEFFREY GITOMER'S LITTLE GOLD BOOK OF YES! ATTITUDE Jeffrey Gitomer (Prentice Hall • \$19.95) <i>Accentuate the positive.</i>	14	2		4 WHAT COLOR IS YOUR PARACHUTE? 2007 Richard Nelson Bolles (Ten Speed Press • \$17.95) <i>The enduring job-search bible.</i>	2	6	
WHY WE WANT YOU TO BE RICH Donald J. Trump, Robert T. Kiyosaki, Meredith McIver, Sharon Lechter (Rich Press • \$24.95) <i>Help for the shrinking middle class.</i>	4	4		5 THE ERNST & YOUNG TAX GUIDE 2007 Ernst & Young LLP (CDS Books • \$16.95) <i>Sharpen those pencils and get out the W-2s.</i>	15	2	
THE ONLY THREE QUESTIONS THAT COUNT Ken Fisher (Wiley • \$27.95) <i>A contrarian approach to investing, by a Forbes columnist.</i>	—	1		6 THE AUTOMATIC MILLIONAIRE David Bach (Broadway • \$12.95) <i>How you can put your investment program on autopilot.</i>	5	13	
MADE TO STICK Chip Heath, Dan Heath (Random House • \$24.95) <i>An examination of why some ideas gain traction while others fade from view.</i>	—	1		7 CRUCIAL CONVERSATIONS Kerry Patterson, Joseph Grenny, Ron McMillan, Al Switzler (McGraw-Hill • \$16.95) <i>Strategies for those all-important talks.</i>	11	12	
WHAT GOT YOU HERE WON'T GET YOU THERE Marshall Goldsmith with Mark Reiter (Hyperion • \$23.95) <i>An executive coach on negative habits that can hurt careers.</i>	—	1		8 A GUIDE TO THE PROJECT MANAGEMENT BODY OF KNOWLEDGE Project Management Institute (PMI Publications • \$49.95) <i>Delivering results.</i>	—	12	
THE STARBUCKS EXPERIENCE Joseph A. Michelli (McGraw-Hill • \$21.95) <i>How the coffee retailer built its following.</i>	8	3		9 THE ESSAYS OF WARREN BUFFETT Warren E. Buffett, Lawrence A. Cunningham (Cunningham Group • \$25) <i>A selection of epistles to Berkshire Hathaway shareholders.</i>	7	3	
JIM CRAMER'S REAL MONEY James J. Cramer (Simon & Schuster • \$26) <i>The "10 Commandments of Trading," from CNBC's wild man.</i>	6	22		10 COLLAPSE Jared Diamond (Penguin • \$17) <i>From Easter Island to Mayan Central America, why civilizations fall apart.</i>	4	12	
THE LITTLE BLACK BOOK OF CONNECTIONS Jeffrey Gitomer (Bard Press • \$19.95) <i>Building relationships with customers, co-workers, vendors, etc.</i>	—	5		11 THE WALL STREET JOURNAL COMPLETE REAL-ESTATE INVESTING GUIDEBOOK David Crook (Three Rivers Press • \$14.95) <i>Finding valuable properties, etc.</i>	—	1	
OUR ICEBERG IS MELTING John Kotter, Holger Rathgeber (St. Martin's • \$19.95) <i>Dealing with change.</i>	10	4		12 THINK AND GROW RICH Napoleon Hill (Ballantine • \$7.99) <i>Willpower and a positive attitude are the keys.</i>	8	21	
THE SMARTEST INVESTMENT BOOK YOU'LL EVER READ Daniel R. Solin (Perigee • \$19.95) <i>A four-step plan.</i>	—	2		13 THE ABC'S OF REAL ESTATE INVESTING Ken McElroy (Warner • \$16.95) <i>Advice from the Rich Dad's bookshelf.</i>	10	2	
WORDS THAT WORK Dr. Frank Luntz (Hyperion • \$24.95) <i>A GOP spinmeister on how business can communicate better.</i>	—	1		14 FIND IT, FIX IT, FLIP IT! Michael Corbett (Penguin • \$15) <i>You can profit from real estate, by a TV show host.</i>	13	12	
THE TAO OF WARREN BUFFETT Mary Buffett, David Clark (Scribner • \$19.95) <i>Wisdom from the Sage of Omaha, compiled by a former daughter-in-law.</i>	9	3		15 RICH WOMAN Kim Kiyosaki (Rich Press • \$18.95) <i>How women can avoid self-sabotage and take control of their finances.</i>	12	9	

LONG-RUNNING BEST-SELLERS

HARDCOVER BUSINESS BOOKS	PAPERBACK BUSINESS BOOKS	PAPERBACK BUSINESS BOOKS
1 GREAT Jim Collins (HarperBusiness • \$27.50)	RICH DAD, POOR DAD Robert T. Kiyosaki with Sharon L. Lechter (Warner • \$16.95)	RICH DAD'S CASHFLOW QUADRANT Robert T. Kiyosaki with Sharon L. Lechter (Warner • \$17.95)
2 COVER YOUR STRENGTHS Marcus Buckingham, Curt Clifton (Free Press • \$30)	THE TIPPING POINT Malcolm Gladwell (Back Bay • \$14.95)	THE 48 LAWS OF POWER Robert Greene (Penguin • \$18)
3 DYSFUNCTIONS OF A TEAM Patrick Lencioni (Jossey-Bass • \$29.95)	GETTING THINGS DONE David Allen (Penguin • \$15)	RICH DAD'S GUIDE TO INVESTING Robert T. Kiyosaki with Sharon L. Lechter (Warner • \$19.95)
4 IK Malcolm Gladwell (Little, Brown • \$25.95)	THE 7 HABITS OF HIGHLY EFFECTIVE PEOPLE Stephen R. Covey (Free Press • \$15)	THE MILLIONAIRE NEXT DOOR Thomas J. Stanley, William D. Danko (Pocket Books • \$15)
5 I'D MY CHEESE? Spencer Johnson (Putnam • \$19.95)	GETTING TO YES Roger Fisher, William Ury, Bruce Patton (Penguin • \$15)	SMART WOMEN FINISH RICH David Bach (Broadway • \$14.95)
6 LITTLE RED BOOK OF SELLING Jeffrey Gitomer (Simon & Schuster • \$19.95)	THE E-MYTH REVISITED Michael E. Gerber (HarperBusiness • \$16)	RICHEST MAN IN BABYLON George S. Clason (Signet • \$6.99)

BusinessWeek's Best-Seller List is based on a survey of chain and independent booksellers that carry a broad selection of books on economics, management, and marketing, small business, investing, personal finance, and careers. Well over 1,000 retail outlets nationwide are represented. Current rankings are based on a weighted analysis of unit sales in January. Titles that have been on the Best-Seller List for more than two years appear as Long-Running Best-Sellers.

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IdeasFaceTime

WITH MARIA BARTIROMO

China Syndrome: How Scary?

WHEN STOCK MARKETS in China took a major hit on Feb. 27, I rang up Don Straszheim, vice-chairman of investment bank Roth Capital Partners in Los Angeles, for some answers. Straszheim was chief economist at Merrill Lynch for a dozen years and is an expert on investment in China.

Why was China so important to this week's market volatility?

For the first time, an event in China's equity markets triggered a reaction around the world. In the last two years, China has gone from being interesting to being important to being top of mind among investors. So when China's equities collapsed, investors around the world concluded, "Oh-oh, this means maybe something important to China's economy. And it may mean something important to equity markets around the world." This wasn't the case five years ago.

Should we be worried that China's economy could crack and set off a ripple effect?

I don't think so. Equities in China are not really important to economic growth. Equity financing is still a small part of raising capital. Far more important than paper gains or losses for Chinese investors is growth in real jobs and income for workers. That's what drives the economy.

China had a huge rally before this week's sell-off. Were the gains warranted?

From 2001 till summer, 2005, China's markets went down about 70%. This was because more people came to realize that China's equity markets were still quite immature...and just stayed away or bailed out. Beijing, in the summer and fall of 2005, decided...we've got to accelerate the reforms we're making in the equity markets. When those reforms were initiated, investors in China concluded this is the start of something big. And so equities rose 130% in 2006 and up another 10% to 30% in early 2007. As enthusiasm got ever greater, it became a mania. No other word to describe it. And for whatever reason, investors in China a couple of days ago concluded, "This is getting increasingly worrisome. We've made fantastic gains, let's take some money off the table." So when you look at this 9%

decline, it's a big number in a day, but it's a small number in terms of the magnitude of the rally over the last 18 months.

How sound are the underlying values of the Chinese stock market?

I'm a skeptic about many of the equities on the Shanghai and Shenzhen markets. First, about two-thirds of those companies remain state-owned. And those markets are dominated by retail investors, not institutional investors—exactly the opposite of the States, Europe, Japan, and other developed economies. Return on equity, price-earnings ratio, book value-to-market value concepts have not yet entered the consciousness of the average Chinese equity investor. The Shanghai and the Shenzhen markets are still highly vulnerable, with enormous potential risk to Western investors.



Does the market still have room to go down? Beijing analysts say it could safely drop 10% more.

This is now really a matter of investor psychology. The market may be over, or there could be another 25% or 40% drop.

Do you think the banking sector could derail China's economic growth?

China's financial sector is its weakest link. The banking system is state-owned, and loans are made more on the basis of non-

financial considerations. The result is that China doesn't have the tools to carefully manage its economy.

What do you tell U.S. investors who lost money this week?

To me, it is more of a buying opportunity than a time to get out and run for cover.

Alan Greenspan just suggested a recession could happen. Do you think the U.S. will fall into recession this year?

No. I think the economy is going to continue to grow at a reasonable pace, something in the 3% range. Most of the demand for housing is over. Almost anybody in this country who has the skills can find a job. And earnings have been rising rapidly the last four or five years. Inflation remains under control. Rates are not at levels that suggest the economy is approaching a danger point. We had a 10-year recovery from 1991 to 2000, followed by a modest recession. We're now in the sixth year of a current expansion, and I think it has many more years to go.

Maria Bartiromo is the anchor of CNBC's Closing Bell.

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Ideas **The Welch Way**

BY JACK AND SUZY WELCH

The Unemployment Act

Are you at all concerned about American competitiveness in the future?

—Srikanth Raghunathan, Irwin, Pa.

Yes. But not for the standard “the sky is falling” reasons, like the twin deficits, low-cost Chinese manufacturing, or intellectual property piracy. We believe those challenges will largely be ameliorated by market, political, and legal forces. No, we’re as worried as can be that American competitiveness is about to be whacked by something no one seems to be talking about: the Employee Free Choice Act, which is currently weaving an insidious path through Congress toward becoming law. If it does, the long-thriving American economy will finally meet its match.

You didn’t read wrong. We know it must sound strange to oppose legislation that promises something as motherhood-y as “free choice.” But the title of this bill is pure propaganda. It won’t encourage liberty or self-determination in the workplace; more likely it will introduce intimidation and coercion by labor organizers, who, after a long slide into near-oblivion, finally see a glorious new route to millions of dues-paying members. Their campaign could trigger a surge in unionization across U.S. industry—and in time, a reversion to the bloated economy that brought America to its knees in the late 1970s and early ’80s and that today cripples much of European business. If you want to be reminded of what that looks like, drive through Pennsylvania’s Lehigh Valley, as we did last weekend, and take a look at all the shuttered factories. Steel—like coal, autos, and so many other industries in the global economy—paid the inevitable price of unionization run amok.

MAKE NO MISTAKE. We don’t unilaterally oppose unions. Indeed, if a company is habitually unfair or unreasonable, it deserves what it gets from organized labor. But the problem with unions is that they make a sport out of killing productivity even when companies are providing good wages, benefits, and working conditions. It is not uncommon in a union shop to shut down production rather than allow a nonunion worker to flip a switch. Only a union or millwright electrician can do that job! Come on. Companies today can’t

afford such petty bureaucracy or the other excesses that often lead to, such as two people for every job and a litigious approach to even the smallest matters. Yes, managers and employees will sometimes disagree. But in the global economy, they have to work through those differences as adversaries but as partners.

The Employee Free Choice Act undermines that. How. Currently, when labor organizers want to launch a unionization effort, they ask each worker to sign a card in show of support. If 30% or more employees do so, a federally supervised election can be called and conducted with the most revered mechanisms in democracy, the secret ballot. Thus, employees can vote their conscience, without fear of retribution from either union leaders or management.

By contrast, under the Employee Free Choice Act, organizers could start a union if 50% of employees, plus one more worker, sign cards. That’s right—no more secret ballot. Instead, employees would likely get a phone call, a pointed solicitation, or worse, a home visit from a small team of organizers. You can just imagine the scenario: The organizers sit around the kitchen table and make their pitch with a lot of passion. Then they slide a card in front of the employee with a pen. Who would say no? Who could?

Now, union supporters will tell you that they won’t intimidate employees for votes, and regardless, management intimidates all the time by threatening to fire employees who vote union. But the system as it exists has safeguards, including heavy fines against companies that misbehave in automatic new elections.

Still, the advance of the Employee Free Choice Act continues unabated. And so pretty soon, if enough business leaders and legislators don’t stand up, it may well be back again, unions. So long, American competitiveness. The change won’t happen instantly. Companies will fight as if their lives depend on it, because they do. But given the logistics of the Employee Free Choice Act, any management campaign is hobbled. If you can’t be at the kitchen table with the organizers and their hard stares, you probably can’t win.

It’s too bad. In fact, it’s terrible. And ironic. First, the ability to unionize already exists in America, thanks to the secret ballot. And second, because the Employee Free Choice Act ultimately only provides a free choice, nobody would ever want: how to spend a government unemployment check. ■

Jack and Suzy Welch look forward to answering your questions about business, company, or career challenges. Please e-mail us at thewelchway@businessweek.com. For their weekly podcast go to www.businessweek.com/search/podcasting.htm.

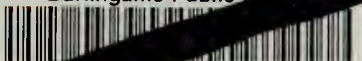
A perspective view of a long, brightly lit tunnel. The floor is covered in a grid pattern, and the walls are white. A yellow box hangs from the ceiling in the center of the tunnel. The tunnel recedes into the distance, creating a strong sense of depth.

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The Trouble With India

bumbling roads, jammed airports, and power blackouts could hobble growth

BY STEVE HAMM (P.48)

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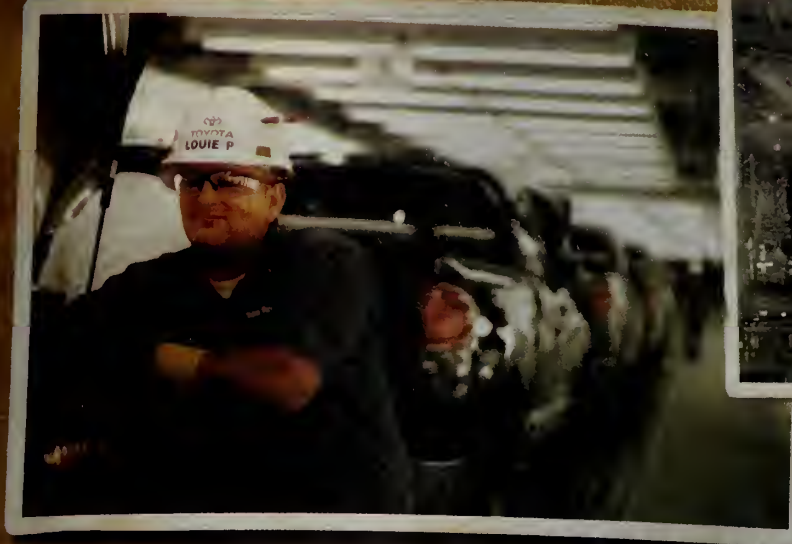




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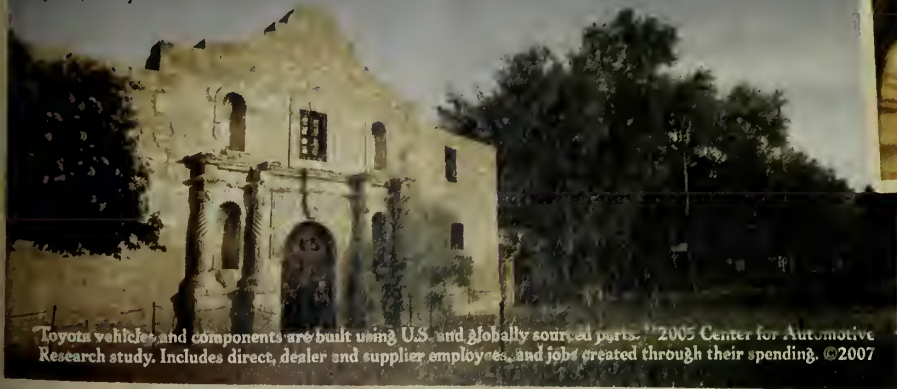
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n about your odds of getting
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ssWeek (ISSN 0007-7135) Issue number 4026, published
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s Offices: 1221 Avenue of the Americas, New York, N.Y.
Podicals postage paid at New York, N.Y. and at additional
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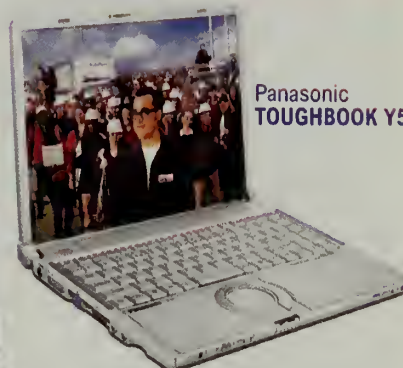
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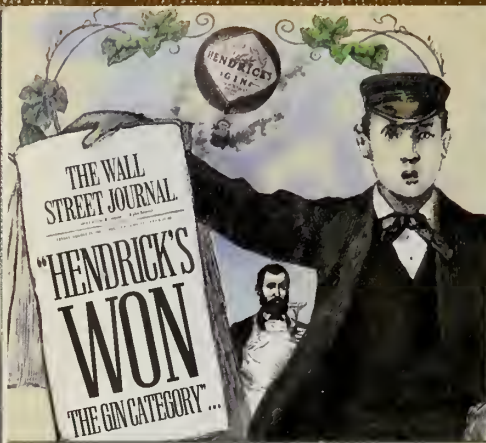
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When it came to our tasting of "white goods," the superpremiums ruled the day. Here, our top three in each category, plus our tasters' comments:

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Bugatti Veyron 16.4
Powerful and price

The Wheels of Luxury

For the status-conscious, few signs of success are more satisfying than a Mercedes or Lexus—or even better, a Rolls-Royce or Ferrari—in the driveway. And while luxury cars are low-volume and relatively low-revenue lines, their strong margins and ability to attract affluent buyers make them integral to companies such



Rolls-Royce Phantom Drophead Coupé

DaimlerChrysler, Toyota, Fiat, and Volkswagen. *BusinessWeek.com* **Special Report on Luxury Cars** looks at the state of the luxury auto market in the U.S. A key issue: Can America build a luxury car again after years of ceding the market to imports? Lincoln seems *hors de combat*, but Cadillac has the CTS, a \$30,000

coupe with the looks and performance to compete with BMW's 3 Series and Mercedes' C-Class. We also ask how one can justify spending six figures on a car (it's not easy, but it can be done), and we grumble about **top-of-the-line cars with the highest recalls**. Last, see our slide shows on the top-selling luxury cars and now-faded marques such as Peerless, Alvis, and Isotta-Fraschini. Go to www.businessweek.com/go/07/luxuryautos for all this and more.

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"Denial is not a good investment philosophy."

—Michael Farr, chief investment officer at money manager Farr Miller & Washington, on the danger of viewing the Dow's 157-point gain on Mar. 6 optimistically, as reported in USA Today

ED BY DEBORAH STEAD



CHICAGO A labor union in support of the Employee Free Choice Act

IONS

to Be Continued in 2009

RETORIC in the House of Representatives is often sweeping, but never so much as when a bill is square in the sights of the most powerful interests in Washington: Big Business and Big Labor. The oratory was strident on Mar. 1 when the House passed the Employee Free Choice Act of 2007 in a largely party-line vote of 275-155. The measure aims to change labor law to allow employees to unionize by having a majority of workers sign petition cards. Opponents say it's an end run around the secret ballot method called for under existing law and that it would permit unions to pressure workers into signing. Watching on **C-SPAN** or listening to the radio and conservative pundits sound like you might think the bill could actually pass this year. But it can't. Even its Democratic supporters concede that getting it passed in the **Senate** would be an uphill battle. And if it should clear that hurdle, now, President George Bush will, as expected, veto it. Still, on the House floor, Representative

Virginia Foxx (R-N.C.) dubbed the measure the "Employee Intimidation Act" and noted that it is favored by the Communist Party of the U.S. Democrats say it's an economic and social-justice issue, with Representative Bruce Braley (D-Iowa) promising that such legislation would help workers reach their "full potential as human beings."

Everyone involved knows the bill isn't going anywhere in this Congress. But it has been declared a top priority by unions that contribute heavily to Democratic candidates and worry about declining membership. It's also a concern of business lobbyists who back Republicans in races and fear increased labor costs.

Today's fight is about a future year, when a Democratic Congress might be working with a Democratic President to sign such a law. It's the initial battle of a larger war to come, says John Gay, a lobbyist at the **National Restaurant Assn.** who is working against the measure. "The harder you fight now, the easier it gets later." —Eamon Javers

THE BIG PICTURE TOURISM'S GLOBAL REPORT CARD

SWITZERLAND tops the World Economic Forum's first-ever ranking of 124 countries based on their appeal as a tourist destination. Austria and Germany were Nos. 2 and 3, respectively. Iceland was No. 4, with the U.S. rounding out the top five. The list is based on 52 variables, from a country's culture to its security. America could improve in a few areas, such as its citizens' attitudes toward foreign visitors—though it still beats France, No. 122, on that score.

—Lindsey Gerdes

Factors affecting travel-and-tourism appeal	U.S. rank (out of 124 countries)
Travel-and-tourism environment and infrastructure	1
Natural and cultural resources	3
Price competitiveness	99
Citizen attitudes toward tourists	101

Data: Travel & Tourism Competitiveness Report 2007, World Economic Forum



REWIND

THE HOUSE MAKES A HOUSE CALL

In the debate over whether companies exert too much influence over patient care, the New York-based Cardiovascular Research Foundation and its founder, Dr. Martin Leon, are central figures. The foundation gets money from medical device makers and uses some of it to stage annual conferences

Special Report



that spotlight their products, including drug-eluting stents used to open clogged arteries (BW—Oct. 23, 2006).

Now the potential conflict of interest has caught the attention of Henry Waxman (D-Calif.), chairman of the House Committee on Oversight & Government Reform. On Feb. 28, Waxman sent letters to stent makers Boston Scientific and Cordis, a unit of Johnson & Johnson. Both donate to Leon's foundation. Worried that stents are being used off-label, Waxman requested reams of marketing data, including "all documents related to funding support for" the foundation. Leon's group says its conferences follow industry guidelines. Cordis and Boston Scientific, which say they'll cooperate, have until Mar. 21 to do so.

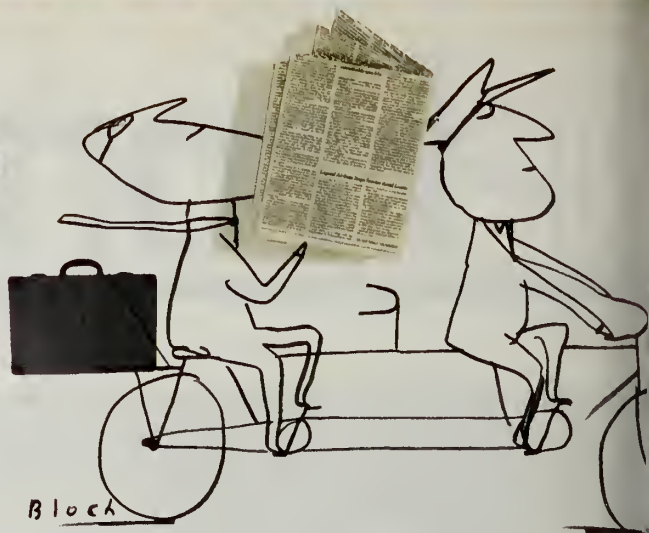
—Arlene Weintraub

PERK PATROL

WHAT THE BOSS DIDN'T GET

THE NEW Securities & Exchange Commission rules requiring more disclosure about executive perks have yielded some long lists this proxy season: private jet usage, mega life insurance policies, country club dues. But energy pipeline giant **Kinder Morgan** complied by declaring what it doesn't dole out: "Unlike many companies, we have no executive perquisites," it declares in its 10-K, in a paragraph brought to light by footnoted.org, which tracks SEC filings.

The company notes that its management got no money for cars, jets, financial planning, or any other privileges in 2006. "We are currently below competitive levels for comparable companies in this area of our



compensation package," Kinder writes slyly.

Kinder spokesman Larry Pierce says "that's the way we've done things since the beginning," adding that the company highlighted its no-perks policy in this year's filing precisely because of the new SEC rules. It may be the last year for such public bragging rights. In August, 2006, Kinder announced it is going private. Its \$22 billion, management-led leveraged buyout awaits approval from the **California Public Utilities Commission**, expected later this year.

—Aaron Pressman

INTERNAL AFFAIRS

THE SPY HUNTER OF BENTONVILLE

BEHIND Wal-Mart's recent announcement that it had fired two computer technicians and disciplined a manager for secretly recording and intercepting phone and text-message communications is one of the world's most legendary spy hunters: former CIA and FBI agent Kenneth Senser.

Senser headed the company's internal investigation into the affair. That led to the Mar. 5 revelation that phone conversations between **Wal-Mart** public-relations employees and *New York Times* business reporter Michael Barbaro had been taped and that a number of text messages sent from or around the company's Bentonville (Ark.) headquarters were also captured and stored.

Senser knows a thing or two about internal espionage. He was the man in charge of reinventing the FBI's internal security operations after the 2001 arrest of bureau agent Robert P. Hanssen, who was spying for the Russians.

Since 2003, Senser has been plying his trade as head of corporate security for Wal-Mart. Besides leading

internal investigations, he has handled issues as varied as the company's preparations for the bird threat and its response to Hurricane Katrina in 2005. Senser did not return phone calls seeking comment. A Wal-Mart spokeswoman says Senser had no involvement in the spying incidents.

He began his intelligence career at the CIA in 1983 and was detailed to the FBI to work on security issues in 1999. In the wake of the Hanssen scandal, Senser, by then the FBI's assistant director for security, helped launch a new analytical unit to look for behavioral clues that would help identify spies inside the bureau. "I was hunting, he told *Time* magazine in 2002, for "v makes the person tick—these things are happeni

—Eamon Ja



SENSER Searching for clues

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BOOK NOTES HOW TO GET RID OF THE, UH, JERKS

WHEN Stanford University management professor Robert Sutton wrote in the *Harvard Business Review* in 2004 that companies should ban bullying personalities from their ranks, he was flooded with approving e-mails. Perhaps not surprisingly, his 2007 book, *The No Asshole Rule: Building a Civilized Workplace and Surviving One That Isn't* (Warner Business Books), is a big seller: In the business genre, it was recently at No. 2 on BarnesandNoble.com.

But couldn't Sutton have picked less inflammatory wording? "There's an

emotional reaction to a dirty title," he says. "You have a choice between being offensive and being ignored." The indelicate appellation aside, the book reasonably argues against keeping arrogant or intimidating employees. And it lists companies—among them, Google, Barclays Capital, and Men's Warehouse—that have policies aimed at preventing the recruitment of such characters. One rule Sutton recommends: "Keep your resident jerks out of the hiring process."

The author also cites corporate leaders who, he says, "lost their jobs...in part because of their demeaning ways," including former Sunbeam chief Al Dunlap and ex-Walt Disney CEO Michael Eisner.

Sutton says he wants the book to spur workplace policies that reform or drive out the nasties and to persuade companies that such bad conduct is contagious. "This is poisonous behavior you catch from other people," he says. We have met the jerks, and they are us.

—Hardy Green

PRODUCE PROVENANCE YES, WE HAVE GREEN BANANAS

Health-food consumers want their bananas green, as in earth-friendly. But how can you check an organic banana's bona fides? In February, Dole Food began labeling its offerings with "farm codes." The stickers send consumers to doleorganic.com, where typing in the three-digit code identifies the plantation that grew the banana, along with organic certification details, worker photos, and satellite map images via Google Earth. Organic Valley, the U.S.'s biggest organic farmer cooperative, has offered a similar feature on its soy milk cartons since 2004. Entering the expiration date at organicvalley.coop/soy brings up bios of the farmers who grew the beans.

—Elizabeth Woyke



MEDIA MELD TO BOLDLY GO BEYOND THE PODCAST

A HIGH-POWERED team of new-media and old-media executives is behind the latest attempt to create TV-like networks for videos shown over the Internet. Next New Networks, or N3, was slated to be launched on Mar. 8 with six channels on subjects from sewing to comics. Within three years, it hopes to build a network of 100 super-niche Web channels.

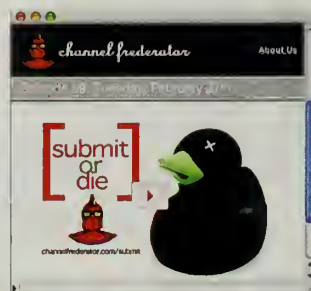
What sets N3 apart from other Web-video efforts is its online take on the TV studio system: Some of the 3- to 11-minute daily or weekly shows combine hired hosts and video submissions from

the audience. Others are mostly clips sent by viewers that N3 edits together. The company is also seeking out online talent—to hire them or license their shows.

N3 started with Fred Seibert (who helped create the notion of branding cable channels at MTV and turned around Hanna-Barbera) and Emil Rensing, an early America Online employee. Inspired

by the popularity of early shows they assembled, such as VOD Cars, a video podcast for car fanatics, and Chan Frederator, a cartoon podcast, they hit on the idea of a broad network assembled a team that combined smarts with Web community know-how. That includes Herb Scannell (who

launched *Dora the Explorer* and *Sponge SquarePants*) and Dan Simmons, who ran Sundance Group, funded with \$8 million from venture fund individuals, including MTV co-founder E. Pittman. —Heather



John A. ...

AVAYA



A photograph of a white sheet of paper with the word "AVAYA" written repeatedly in a cursive script. The text is arranged in a series of parallel lines that recede into the distance, creating a strong sense of perspective. The paper is placed on a blue surface, and a dark object is visible in the upper left corner.

ECO WATCH

The Eyes of Texas Are Still on TXU

TO THE LIST of those complaining about the environmental shortcomings of the recently announced private equity deal for the big Texas utility **TXU**, add a formidable opponent: eco-conscious Dallas Mayor Laura Miller.

On Mar. 5 and 6, David Bonderman, a founder of **Texas Pacific Group**, one of the firms in the private-equity consortium, flew to Dallas to meet with Miller and business and citizen groups for a round of talks that may prove decisive to the TXU sale.

Miller, 48, is a force to be reckoned with. A former Dallas City Council member, community activist, and newspaper reporter, she's at ease in a fight. As mayor she has clashed publicly with

city council members and is willing to wrangle with local businesspeople, some of whom are still bitter over her opposition to development tax incentives.

Last year, with the backing of oil billionaire Ed Bass, Miller created a coalition of cities that galvanized opposition to TXU's plans to build 11 coal-fired plants in Texas.

Dallas' mayor thinks Texas got the worst of a deal with a utility and private equity

After looking at terms negotiated by **Environmental Defense** and the **Natural Resources Defense Council** in the Feb. 26 TXU sale, Miller and local groups decided that the utility-private equity consortium got the best part of the deal.

Environmental Defense and the NRDC disagree. The two groups gave the nod

MILLER In new talks with TXU and its bidders

to TXU's \$45 billion sale to Texas Pacific Group, **Kohlberg Kravis Roberts**, and **Goldman Sachs Group** after the buyers consented to a 10-point agreement that includes building only three plants. True, after the buyout was announced the utility said it had already been planning to build a smaller number of plants. But the NRDC and Environmental Defense point out that these cuts are now guaranteed.

Miller—who was not part of the negotiations—and her coalition and local groups want further concessions. At the Mar. 5 meeting with Bonderman, she demanded that TXU agree

not to reapply for coal-permits in Texas, use less polluting technology for plants, and clean up existing facilities. "It was a good meeting, and we're going to continue talking with mayor," said Jeff Eller, a spokesman for the private equity consortium.

If TXU doesn't satisfy critics, its new owners will face fierce resistance. The experienced activists intend to lobby Texas lawmakers on ways to rein in the utility and legally fight the building of proposed new coal plants. Miller, who crisscrossed the state last year to build opposition, isn't about to stop now. —Heather C

QUESTION OF THE WEEK

TV footage of rats invading a New York City KFC/Taco Bell is all over the Web. What can Yum! Brands do to counter negative images in the era of YouTube?

"They can't turn off the shock appeal of the first video, but they can post their own—explaining measures they've taken—on YouTube, tagging it with the same keywords so it appears alongside the other clip."

—Diana Brainerd, president, Brainerd Communicators

"You can only fight visuals with visuals. The company should release videos showing its sanitary programs in action. It's not as sexy as vermin running rampant, but it's the best of their limited options."

—Eric Dezenhall, CEO, Dezenhall Resources

"The company needs to come up with a startling, blockbuster promotion. It needs to be more significant than a Super Bowl commercial because, frankly, the franchise is at risk all over the country."

—Robert Dilenschneider, founder, The Dilenschneider Group



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“Jack, [the global warming] debate is over, and the scientists have won.... There is no more time for fence-sitting.”

—Ian Keay
Palo Alto, Calif.



THE WELCHES NEED TO FACE FACTS ABOUT GLOBAL WARMING

BACK IN THE DAY, Jack Welch would annually evaluate his managers, fire the bottom 10%, and lavish praise and bonuses on the performers. But now in “The global warming wager” (The Welch Way, Feb. 26) he has flipped the other way and seems intent on firing the overwhelming consensus of scientists and promoting the 1% of deniers.

Jack, this debate is over, and the scientists have won. There is no other side, there is no on the other hand, there is no more time for fence-sitting and prevarication. It is real, it is worsening, we are causing it, and the later we change course the worse it will be and the more it will cost our children and grandchildren.

We will be reengineering the industrial infrastructure of our global civilization over the next 50 years. General Electric Co. stands poised to make scads of money from it. The “Electric” in General Electric will be a huge component as we move away from fossil fuels. I, for one, intend to be part of the solution, glancing up from my labors on high, dry land to see the Jack Welches huddle on their ever-diminishing iceberg, heading

out into turbulent warming waters, debating what is real and what is not.

—Ian Keay
Palo Alto, Calif.

GIVEN THE PARTISANSHIP that grips Washington and the media culture that feeds on such divisiveness, Jack and Suzy Welch’s uncertainty about global warming is understandable.

If they were to talk to actual climate scientists, however, and avoid the spin doctors trying to overlay their agendas onto media interpretations of the science, they would come away understanding that the case for a human fingerprint on climate change is close to airtight.

Regardless, it was heartening to read their message that business should plan as if global warming will have far-reaching impacts on human society. Many have likened reducing greenhouse gas emissions to paying an insurance premium in order to reduce unbearable risks. That analogy doesn’t quite hit the mark. Cutting emissions through energy efficiency and other process improvements will have lasting business benefits, even if, somehow, *The Wall Street Journal*’s

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The McGraw-Hill Companies

BusinessWeek
MARCH 19, 2007 (ISSN 0007-7135) *** 4026

Published weekly, except for one week in January, July and August by The McGraw-Hill Companies, Inc. **FOUNDER:** James H. McGraw (1860-1948).

EXECUTIVE, EDITORIAL, CIRCULATION, AND ADVERTISING OFFICES: The McGraw-Hill Companies Building, 1221 Avenue of the Americas, New York, N.Y. 10020. Telephone: 212-512-2000. Telex: Domestic 127039; Intl. 2360127039. For single copy sales call 1-800-298-9867 or email: busweek@mrmsinc.com. Subscriber Services: 1-800-635-1200. TDD: 1-800-554-1579

POSTMASTER: Send address changes to BusinessWeek, P.O. Box 8418, Red Oak, IA 51591-1418. Periodicals postage paid at New York, N.Y., and at additional mailing offices. Canada Post Publication Mail Agreement Number 40012501.

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ReadersReport

diehard ideologues know something thousands of scientists don't.

—Jim DiPeso

*Republicans for Environmental Protection
Seattle*

WE OBJECT TO Jack and Suzy Welch equating the status of the global warming debate to that of the political debate between Democrats and Republicans about the state of the U.S. economy or the status of war in Iraq.

Far from being a political debate, the current Intergovernmental Panel on Climate Change report is a sobering assessment of the possible impact of climate change on human civilization and the natural world. This conclusion is based on the best of current scientific measurements, observations, and climate modeling simulations, all published in the peer-reviewed scientific literature.

To equate hundreds of scientific studies with an opinion piece in *The Wall Street Journal* indicates that we have truly entered an age where truth is relative.

We need to change our way of thinking from short-term, bottom-line models to one that spans decades or even centuries and that takes the needs of both human and nonhuman communities, present and future, into account.

—Roger DeKock and Kenneth Piers

*Professors of Chemistry
Calvin College
Grand Rapids, Mich.*

A VOTE OF CONFIDENCE IN CITI'S CHUCK PRINCE

THE STATEMENT YOUR reporter elected to use from my interview for "The real scandal at Citi" (News & Insights, Feb. 26) could lead readers to incorrectly interpret the comment as a less-than-enthusiastic assessment of Chuck O. Prince's performance to date. As I stated in the interview, I believe Chuck has acted decisively and has taken bold steps to continue to position Citigroup for growth, while delivering an impressive current return on equity. I also believe he is putting the company on the right course to capitalize on the opportunities available to it as a result of its unique and powerful global franchise.

—Jay S. Fishman

*Chairman & CEO
Travelers Cos.
St. Paul, Minn.*

KEEPING DIVORCED PARENTS FROM BECOMING DEADBEATS

WHILE IMPRISONING deadbeat parents sounds like the right thing to do, if you

look deeper into the story, they are dead-broke parents ("Pepperoni, on! hand cuffs," Up Front, Feb. 26).

Debtors prisons were eliminated y ago, with the exception of child-sup debt. Here we throw dads and (ra moms into jail. Not too many pa can meet their obligations from a pr cell. Can you imagine if we threw American debtors into prisons and their pictures on pizza boxes? I c think the country has enough boxes

—Peter G.

Weston, A

HOW TECH CAN DELIVER THE 'WOW FACTOR'

AS A USABILITY engineer, I loved se my field described as the "wow facto "Trimming the fat from technology" Front, Feb. 26).

Many technology companies are g of thinking that the way to make products more attractive is to add tures that customers may or may really want. It is a sad reality that usability is so rare that it elicits a "v reaction from customers.

Most user studies find that p prefer products that are easy to and easy to use. But they get sucke buying products based on long fe lists because they can't tell how the product is to use while they a the store.

If companies want to develop customers, they should focus on use and not worry so much about havir longest feature list in the store.

—Marc R.

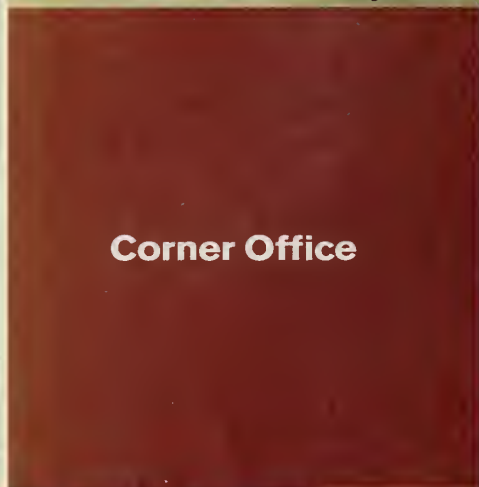
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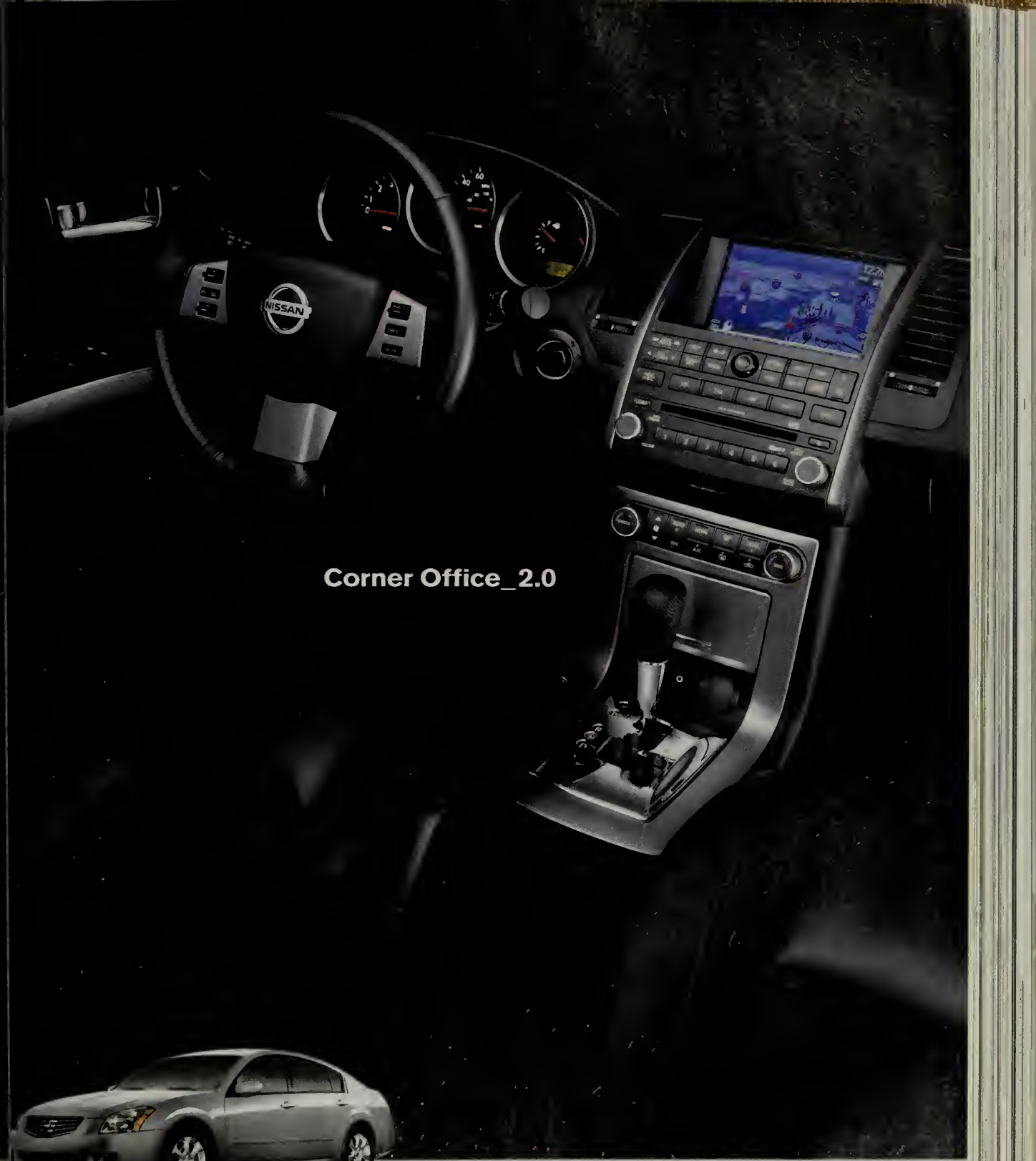
INNOVATION IS NOTHING TO SNEEZE AT

AT THE END of Michael Arndt's review of *Payback* by James P. Ar and Harold L. Sirkin, he says: "T also ample payback in being rem that innovation is likely to be no of a fix-all than management fa the past" ("Turning ideas into do Books, Feb. 26).

Real innovation as practiced by companies is not a fad. It is the con tion of technical invention and bu insight for creating products thate rate revenue and profit. For exa research at IBM is aligned with cor needs and for many years has succe helped turn inventions into produc in the marketplace. To promote it tion, it is necessary to create a cultu supports some risk-taking, but al cludes the careful development of st

Corner Office





Corner Office_2.0



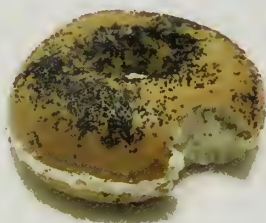
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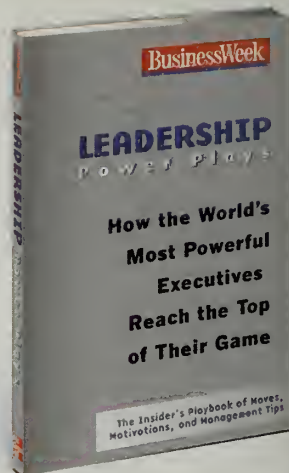
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Hunger.



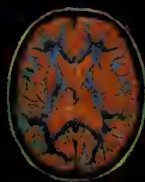
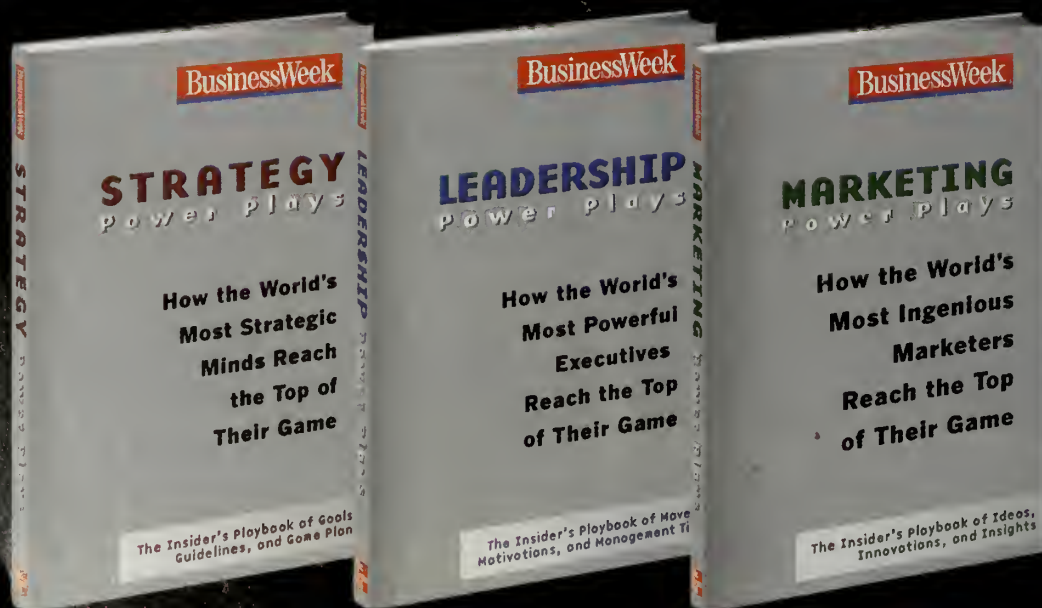
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research and development projects
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ation is an evolving process and
includes research in services and
ess models.

—Robin Williams

Former Associate Director
IBM Almaden Research Center
San Jose, Calif.

CORPORATE SPYING EASY

WITH great interest your recent
“Spies, lies & KPMG” (Investiga-
Feb. 26). As a strategic intelligence
ssional, I have often been asked
ents to provide counterintelligence
el to deal with circumstances simi-
those you describe. What is invari-
ound in such cases is that in an
usingly globalized economy, intelli-
gathering by any means is a simple
f life. Unfortunately, many organi-
is do not convey this information to
employees, making them easy prey
entreaties of individuals utilizing
e forms of pretext.

—Alden R. Taylor

Managing Partner
Strategic Insights
Stamford, Conn.

CORRECTIONS & CLARIFICATIONS

get Davos. I'm booked up for TED”
Tech, Mar. 12) reported that the Apple
intosh was first unveiled during the
uary, 1984, TED conference. The
intosh made its debut at a Jan. 24
eholder meeting, one month earlier.

etworking (Inside Innovation, Mar. 12)
ld have said that 130,000 recruiters
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Where Search Stumbles

Searching the Web, I can find the text of Chaucer's *Canterbury Tales* in Middle English or the definition of an elliptic curve. But can I find a near supermarket or pharmacy open at 2 a.m.? Clever as search tools are at ferreting out the obscure and global, they tend to fall down badly at the mundane and the local, despite major investments by search providers.

I went looking for a variety of services in downtown Washington D.C. using four major search companies: Google, Yahoo!, Microsoft's Live, and Ask.com. Each did better at some things than others and no clear winner emerged. In fact, in certain respects, all of them disappointed.

A search for an all-night drugstore seemed like an easy and realistic first test. I asked each service to find a "24-hour pharmacy" with Zip Code 20005 as the starting point. To my surprise, only Yahoo! Local (local.yahoo.com) achieved reasonable success, pointing me to a CVS store within a mile. Google (local.google.com) and Live (local.live.com) both came up with Kaiser Permanente facilities that only serve HMO members and, in any event, aren't open 24/7. Ask (city.ask.com) found nothing matching my request.

Local search is better at accommodating a taste for *saag paneer* than a need for midnight medication. Searches for "Indian restaurant" turned up something useful from each service. The results were still mixed, with non-Indian establishments on all the lists but Live's. And Google's top suggestion was several miles from downtown.

AS EVERYONE KNOWS, sex drives a lot of Internet commerce, so I decided to give the search tools a mildly risqué test, looking for "sex toys." Yahoo and Google both put reasonable, nearby suggestions in the top spot of their results, though Google oddly offered Microsoft's Washington corporate affairs office as the sixth item on its list. Ask came up with a puzzling list of 10 electronics stores. Live said it could find nothing matching the request. Flowers proved to be much less of a challenge. All of the services responded to "florists" with a reasonable list of local stores.

My final test was to look for a "jazz show." Ask did the best when I selected its "Events" search option. Yahoo offered a list that mainly contained upcoming local performances. Google focused on venues rather than specific performances.



Looking local can still baffle big search engines

Live offered the Web pages of local performers. Similarly, Ask was the only service that did a reasonable job of finding near movies.

There are a lot of reasons local search does so badly. The main one is that the tools that scour the vast Web, guided by keywords and sites' popularity, are boggled by local searches. The algorithms don't know that a Kaiser Permanente pharmacy isn't open to the public or that a 24-hour refill line is different from a 24-hour store. When the process is more focused and automated, as with Ask's list of performances, search works much better.

At its best, obviously, local search is a lifesaver. All of the local search services are tied in with their parents' mapping features, which can provide walking or driving instructions well as a map.

But this does you no good if the service can't figure out what you're looking for. Fortunately, there are alternatives to local search engines. Services with human input, such as Citysearch or the user-generated Yelp, are better at finding restaurants. Fandango or MovieTickets.com will locate your movies—and sell you a ticket. And the old-fashioned Yellow Pages came through with the all-night drugstores that got the search services so much trouble. ■

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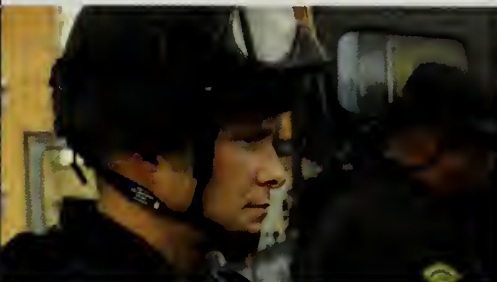


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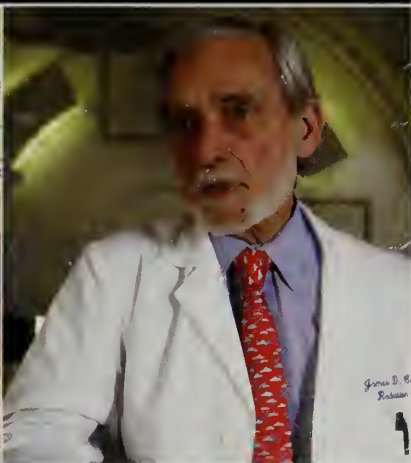
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A Small Drop in Bud's Barrel

What is happening with Anheuser-Busch, proprietor of Budweiser and other iconic Middle American beer, mirrors much of what's up with big marketing and media right now. There's the pursuit of the elusive 25-year-old Everyman. There's the struggle to recalibrate how the brewer sells brands in stupendous volumes amid the vicissitudes of an uncooperati-

and fractionalized market. And there's the inevitable big-sounding bet on new-school advertising and platforms. Or at least it sounds big. Next to the brewer's overall media budget, though, not so much.

Anheuser-Busch and its rivals are fighting a gradual un-beering of America. In 2005, the last year for which there are data, U.S. beer sales fell, again. The top two beer companies—Anheuser-Busch is the biggest—lost share, according to figures cited by *BusinessWeek's* corporate sibling *Standard & Poor's*. Historically, category-leading companies such as Anheuser-Busch pushing middle-of-the-road fare have succeeded by keeping a ferocious mass-marketing machine fully cranked. That's what household giant Procter & Gamble, for one, still does. But most of Anheuser-Busch's customers are the young men widely believed to be disappearing from standard media channels.



BUD.TV A \$30 million investment—but a fraction of Anheuser-Busch's ad budget

WHICH IS WHY Anheuser-Busch will shell out \$30 million on Bud.TV, its well publicized bid to create video programming on its own Web site. It also inked a deal with nascent social networking site MingleNow for a promotion called “clink,” in which users post photos toasting one another with beer. Tony Ponturo, Anheuser-Busch's vice-president for global media and sports marketing, says that \$30 million will be roughly the annual cost for building and maintaining Bud.TV. Ponturo also says the company is “reengineering” its ad mix this year, even while overall spending will stay roughly flat with 2006, when, according to TNS Media Intelligence, the company spent \$509.2 million on media. The changes, Ponturo says, will shift dollars away from nonsports TV and boost digital spending by around 50% this year. Consider, though, that in 2006, Anheuser-Busch spent \$386.9 million on TV. So the total spending on Bud.TV is less than 8% of last year's TV budget. By contrast, Microsoft is shifting its marketing dollars around far more aggressively. Senior

Vice-President Mich Matt told attendees at a recent marketing conference that the next three years Microsoft will move most of its ad budget to the digital realm. “Interaction,” said Matthews, “is even more valuable than exposure.”

Interaction is a slippery slope for a beer company, though. Institute guidelines governing marketing to underage drinkers require would-be Bud.TV visitors to navigate a relatively involved—though by no means foolproof—registration and checking process. Ponturo says that only 10% of all visitors to the front page are registered. (This has not stopped 23 state attorneys general from

complaining about age concerns.) MingleNow's club photos will be monitored to ensure that drunken shenanigans won't dominate, although Tom Shipley, Anheuser-Busch's senior director for global industry development, implies that those guidelines may not be the pictures that fans post.

As with so much else that the largest players attack online, Bud.TV and clink are admirable enough in principle, although, thanks in part to industry guidelines, no one will mistake them for the most fluid and forward-leaning precincts of the Web. So what of the other advertisers, those who spend hundreds of millions of dollars, monitor those buys obsessively, and pore over data before shifting a penny? They win ink for ad plays while placing over 90% of their budgets on TV. Maybe big brands find that old, clunky marketing gone by still—gasp—works well enough. ■

BusinessWeek .com



For Jon Fine's blog on media and advertising, go to www.businessweek.com/innovate/FineOnMedia

JAMES C. COOPER

The R-Word is 'Rocky,' Not 'Recession'

...the economic ride ahead will be bumpy—but manageable

U.S. ECONOMY In the financial markets, a little fear is a good thing. It helps investors make smarter decisions and avoid complacency. Thanks to sage advice on the inevitability of the business cycle from former Federal Reserve Chairman Alan Greenspan, and as the result of a sudden plunge in Chinese stock prices, investors are coming back

to the notion that the world is a risky place after all. But they shouldn't get carried away, especially with the R-Word. Recessions are a fact of life, and they are largely predictable. It's a safe bet that the U.S. economy won't experience one anytime soon.

Classic warning signs just aren't there. Consider the economic landscape before the 2001 recession. Prior to the official start of that downturn in March, 2001, the Standard & Poor's 500-stock index had plunged 25% in the previous six months, and spreads between corporate bonds and Treasury notes, a measure of credit tightness, had widened sharply. Corporate earnings had been falling for more than a year. Businesses were caught with a mountain of inventories as the annual growth rate in overall demand slumped to 2.2%, from 4.2% the year before, and manufacturing output was sliding straight down.

Fast-forward to 2007. As of Mar. 7, the S&P 500 index is down about 4% from its February peak. Credit spreads have widened, but not by much and from very narrow levels. Corporate earnings just finished 2006 with a record 14th consecutive double-digit advance. The companies with inventories are small, narrowly based, and have been largely eliminated by resilient demand, which has shrunk only 3.3% over the past year. And manufacturing appears to be firming up, based on the February report from the nation's purchasing managers. These are not the kind of signs that point to big trouble.

NOT THAT THE RECENT market turmoil is a concern. The cost of capital is now generally higher than it was, and investors and lenders have a lower tolerance for risk. This pattern raises some red flags. The looming threat is the most press is the subprime mortgage market, which could generate a broader credit crunch. However, the bigger danger is rooted in the psychology of consumer and business behavior, not in any great economic impact from the market's plunge. For example, the immediate wealth effect on consumers from the drop in stock prices so far is not a major blow. The broad Dow Jones Wilshire 5000 index, which correlates well with the stock portion of

household net worth, is still a shade above its fourth-quarter average and about 14% ahead of the low hit last June. Also, the resulting credit-tightening has not been great enough to adversely affect consumer borrowing outside of subprime mortgage lending or corporate financing for new equipment and expansion.

Nevertheless, both consumer and business confidence are bound to take a hit. For consumers, the shock will be mitigated by the strength in the job markets. Personal income from wages and salaries jumped 1.2% in January from December, partly reflecting a boost from bonuses, especially on Wall Street. Over the past year, overall wage income is up 5%, beating inflation by nearly 3%.

THE SECTOR TO WATCH most closely is U.S. business. The biggest threat to the economy in coming months is a major swing in corporate sentiment that cuts further into both capital spending and hiring. Corporate outlays have been a strong support under the economy, and the accompanying additions to payrolls have buoyed consumer spending, in the face of high gas prices and the housing slump. In recent weeks new claims

CEOs EXPECT STEADY BUT SLOWER GROWTH



for unemployment insurance have turned upward, a trend that bears watching. The rise could simply reflect a return to normal weather conditions after an early mild winter—or a new round of corporate caution.

Despite solid balance sheets and readily available funds from both internally generated profits and outside credit, businesses already were pulling in their horns beginning last summer. Questions over the economic impact of the housing slump and higher energy prices led to a drop in outlays for new equipment and buildings in the fourth quarter, and wariness continued into the first quarter. In January, production of business

equipment fell, and new equipment orders plunged. Now comes the market jolt, which is sure to prompt even more conservative decision-making in the boardroom.

The view from CEOs in the first quarter, prior to the Feb. 27 market slide, was a smidgen more upbeat than in the fourth quarter, based on the Business Roundtable's CEO Economic Outlook Survey. The group's Economic Outlook Index, a composite of CEO expectations for sales, capital spending, and hiring in the coming six months, rose three points, to 84.9, but this overall assessment remained at a relatively subdued level compared with 2005 and early 2006 (chart, page 31). Managers were looking for steady growth in coming months, with no big speedup or slowdown from current conditions, but it's easy to see how recent events may have nudged expectations down a notch.

MORE THAN LIKELY, THOUGH, the current weakness in capital spending does not signal any great or lasting pullback. Regional surveys of capital spending plans by several district Federal Reserve banks suggest the lull is temporary. Economists at JPMorgan Chase have compiled these plans into an index that tracks equipment outlays fairly well, and the measure suggests capital spending will grow at a steady pace in coming months.

The softness in business outlays has coincided with the weakness in manufacturing, which is largely the result of efforts by businesses to reduce top-heavy inventories. Consider that manufacturers account for about one-fifth of all outlays for equipment. With output and rates of capacity utilization declining, many factories

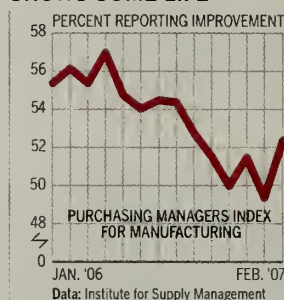
have temporarily shelved their expansion plans.

However, recent signs suggest the inventory adjustment, while not yet complete, is well advanced. January manufacturing inventories fell for the first time in almost a year, and in February the Institute for Supply Management's factory activity index strengthened

notably on gains in orders and production (chart).

Moreover, when companies are ready to expand, financing shouldn't be an issue. With almost all of the S&P 500 companies having reported for the fourth quarter, earnings are up 11.7% from a year earlier, according to Thomson Financial.

THE FACTORY SECTOR SHOWS SOME LIFE



excluding the big drop in the energy sector, they're up 15.9%. In the coming year, profits are bound to slow, a high single-digit pace is hardly weak. Margins, which topped out, are still at a historically high level.

With central bank policies in the U.S. and around the world not overly tight compared with the restrictive financial conditions that often have preceded past recessions, the danger of a generalized credit crunch is small, at least for now. As long as credit is flowing, jobs and incomes are rising, and profits are growing, it's too early to start talking about that R-word. ■

HOUSING

Builders Bite the Bullet

INVESTORS GOT nervous after the big fall in January sales of new homes. But it's unlikely that the housing recession has suddenly deepened. Rather, homebuilders have set themselves up finally to reduce their inventories of unsold homes.

The month's 16.6% plunge in home sales sent share prices of homebuilders reeling on fears that demand may have dropped another peg. U.S. economist Michael Moran of Daiwa Securities believes, however, that the "lion's share of the adjustment in housing construction is behind us." Moran points to the average gap between housing starts and new single-family home

sales in the three months through January, which sank to a 25-year low of 179,333 on an annualized basis. Historically, housing starts outpace sales by about 400,000 per year. The perennial difference is due to individuals who hire a builder to construct their homes. These are captured in the housing starts data but not home sales figures since the units never hit the market.

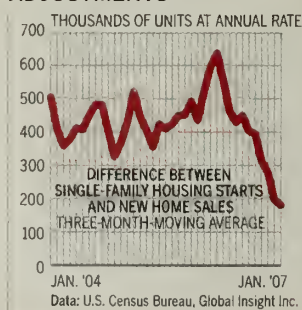
While sales have certainly slowed, the narrowing between starts and sales is largely the result of an abrupt pullback in new construction. Starts were off nearly 40% from a year ago in January, while sales were down 20% over the same period.

The adjustment in construction, especially relative to sales, will "lead to a drop in housing completion and a trimming of inventories," Moran. Averaging the positive effect of mild weather on November and December housing statistics with the negative impact evident in January and (most likely) February, Moran sees sales hovering around an annual rate of 1 million homes. That would bring inventory levels back to a comfortable level by early next year.

Clearly, risks remain. Government data don't put canceled purchases of new homes back into inventory figures. Tighter lending standards could also reduce the number of potential buyers. Those factors could prolong the inventory adjustment. But otherwise it appears that the big economic drag from residential construction is set to ease. ■

—By James Mehring in New York

BUILDERS HAVE MADE BIG ADJUSTMENTS





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MARKETS: STILL JITTERY

The big, bad market crash may have to wait. As of press time it seemed that the Feb. 27 global stock sell-off, which started with Chinese bourses tanking and culminated in a 416-point decline in the **Dow**, had not stopped buyers. They came back with a vengeance on Mar. 6, bidding up America's major indexes to their biggest rally of the year. Developed and emerging-market benchmarks sprang back even more. As for the instigator, China: Even after Feb. 27's one-day 9% rout, mainland shares are still up 9% in 2007.

Still, the **S&P 500** remains down 2% this year, Japan has slipped 3% (photo, a Tokyo storefront indicator), and Russia and India have each dipped in excess of 8%. Wall Street bears can point to heightened volatility and growing anxiety over subprime mortgage rot. Meanwhile, bulls shout that the market remains fairly valued, earnings are still growing—and the **Federal Reserve** can always open the liquidity spigot if and when the economy starts to look parched.

ONLINE "A brief respite, then more pain for stocks," www.businessweek.com/go/tbw

Street Scams?

Tales of insider trading are once again shaking Wall Street. On Mar. 1 federal prosecutors and regulators announced the filing of criminal and civil fraud charges in one of the largest insider trading cases in two decades. The authorities busted 13 people including a **UBS** executive director and a former **Morgan Stanley** compliance officer in a series of schemes that allegedly netted at least

\$15 million in illicit profits. The next day, the **SEC** charged unknown people with scoring at least \$5.4 million by trading in advance of the \$45 billion offer for utility giant **TXU**.

ONLINE "The century's big insider-trading bust," www.businessweek.com/go/tbw

RIM's New Numbers

Research In Motion, seller of the boffo **BlackBerry** wireless device,

is making every effort to look like it's doing the right thing. The company, one of more than 140 facing scrutiny over options grants, said on Mar. 5 that it would take a \$250 million noncash charge to account properly for grants made between 2002 and 2006. **RIM** also said that while no one did anything wrong, it was shaking up management. Co-CEO **Jim Balsillie** relinquished his seat as chairman, and the

board was reshuffled. In other handheld news, *The Wall Street Journal* reported on Mar. 5 that **Palm** is working with **Morgan Stanley** to study options, including a sale of the company.

Lining Up at Chrysler

Will private equity grab the driver's seat at **Chrysler Group**? **Cerberus Capital Management** and **Blackstone Group** have joined **General Motors** on the short list of serious bidders for the **DaimlerChrysler** unit. Both firms met with the company the week of Mar. 5. Blackstone has experience in the auto industry as majority owner of parts maker **TRW Automotive** and formerly an investor in **American Axle & Manufacturing**. Cerberus acquired 51% of GM's **GMAC** finance unit last year.

Subprime Indeed

Speeding the downward spiral in the subprime mortgage market, **New Century Financial** on Mar. 2 said it was under investigation for questionable sales and accounting errors. On Mar. 7 its stock had sunk 6%. See "Who will get shredded" page 39

Wal-Mart Watchdogs?

The Bentonville (Ark.) behemoth said on Mar. 5 that a puter technician over several months intercepted messages and taped phone calls between employees and a reporter for *The New York Times*. The company fired two snoopers and disciplined a manager. Few gumshoes are on the trail. See "The spy hunter of Bentonville," page 12

Citi's Big Move in Japan

How's this for a comeback? In the fall of 2004, Japan's financial regulator told **Citi** to shutter its private bank allegedly misleading clients about investments and man-

that were used to ma-
late stocks. Rehabilitated,
emerged as a white knight
a \$10.8 billion bid on
6 for **Nikko Cordial**, Japan's
-largest broker. The deal
d be the biggest foreign
ision in Japanese history.

► "Tokyo comeback:
buys Nikko,"
[businessweek.com/go/tbw](http://www.businessweek.com/go/tbw)

Way, Mr. Icahn
phone maker **Motorola**
to hang up on **Carl Icahn**
ar. 2, filing a proxy with
EC urging shareholders
to vote with the billionaire
st, who owns at least 1.4%
company and has said
unts a seat on the board.
t, meanwhile, escalated
ng documents saying he
ds to buy more than 4.4%
company. Judging from
s history, he may settle
otorola's using some of
1.2 billion cash hoard for
k buyback. Sources say
are already taking place.

us Takes Flak
uing fears of unrest that
zap production, thou-
of French workers struck
s on Mar. 6 to protest
to eliminate 10,000 jobs
r countries. Meanwhile,
h pols called for a strong
role in the planemaker's
rt, **EADS**—a rebuke to
agers who say Airbus is

CAMPAIGN OF THE WEEK

hey're everywhere: ads from **Gap**, **Apple**, and others flogging
nchandise benefiting the charity **Global Fund to Fight AIDS, Tuber-**
culis & Malaria. So just how much has this high-profile (**Product**)

RED campaign, fronted by singer
Bono and running for about a year,
raised? Some \$18 million, reported
Advertising Age on Mar. 5. Doesn't
seem like much, right? **Julie Cordua**,
marketing chief for RED, says it's
actually \$25 million, since some
participating companies haven't yet
closed their 2006 books. She adds

SENDING THE MESSAGE

h the \$6 billion Global Fund over the previous four years had
cocted only \$5 million from private sources, a fraction of what
RED has raised. "We think it's great," she says. But the amount
is less than what the half-dozen companies, which donate a
portion of profits from selling RED items, spent to market those
goods. Some estimates put that number at \$100 million. Cordua
sa the actual figure is "far less" and would have been spent as
a of the companies' regular ad budgets. As for RED's target in
207, Cordua says, "we haven't set a goal."

already hamstrung by political
interference. Airbus also had to
ground a planned cargo ver-
sion of the **A380** megajet after
its last remaining customer,
UPS, canceled an order for 10
freighters on Mar. 2.

More Magic for Merlin

Waxworks and theme parks
aren't for kids only. Just ask
private equity giant **Blackstone**
Group, whose **Merlin Entertain-**
ments spent just under
\$2 billion on Mar. 5 for **Tus-**
sauds Group, owner of the
London Eye ferris wheel and the
Madame Tussauds wax museum
franchise. The deal makes
Merlin, which bought Den-
mark-based theme park chain
Legoland in 2005, the world's
No. 2 attractions operator
after **Walt Disney**.

ONLINE "No mystery in
Blackstone's wax museum,"
www.businessweek.com/go/tbw

Calling All Telecoms

The folks at **Alltel** know there's
little future for a sleepy
regional phone company, so
they're dialing for a suitor.
Sources confirmed on
Mar. 6 that Alltel has talked
with the likes of **Verizon**, **Sprint**,
and **AT&T**. Alltel declined
comment. Analyst reports say
Alltel could fetch \$25 billion
to \$30 billion. That stiff price
makes it unlikely a deal will
get done soon.

AT&T and Cingular have combined to cover half the cities we do.

Sprint Mobile Broadband covers 2x more cities than their BroadbandConnect.



PX-500 by Pantech®

It's the nation's largest and fastest mobile
broadband network. With Sprint you can
make just about any place a workplace. And
now get a mobile broadband card for free.

**FREE
CARD**

with new card activation on unlimited
data access plan. Requires 2-yr
agreement and \$49.99 mail-in rebate.
No voice plan required.

1-8SPRINT-BIZ
sprint.com/mobilebroadband

Sprint  **POWER UP™**

Together with NEXTEL

Fastest mobile broadband network claim based on combined weighted average of upload and download speeds on the Sprint Mobile Broadband Network, including Revision A-enabled markets, compared with publicly available average speeds on other carriers' mobile broadband networks. Actual speeds may vary. Access to Rev. A speeds requires a Rev. A-capable device/connection card. See sprint.com/mobilebroadband for details. Sprint Mobile Broadband Network reaches over 200 million people. Rev. A enhancements reach over 95 million people. Coverage not available everywhere — see sprint.com/coverage for details. Not available in all markets/retail locations. Coverage comparison based on most recent available information regarding Cingular broadband market coverage as of 1/26/07. Free Card Offer: Subject to credit approval. Additional restrictions apply. Mail-in Rebate: Requires purchase by 3/31/07 and activation by 4/14/07 of new line on Unlimited Data Plan (\$59.99) and two-year agreement. \$36 activation fee and \$200 early termination fee apply. Rebates cannot exceed purchase price. Taxes excluded. Line must be active 30 consecutive days. Allow 8-12 weeks for rebate. ©2007 Sprint Nextel. All rights reserved. Sprint, the "Going Forward" logo and other trademarks are trademarks of Sprint Nextel.

THE ECONOMY

UNDER THE FED'S HAMMER

How Fed rate hikes have
turned into a regressive
tax on weak borrowers

BY PETER COY





THE CRASH IN SUBPRIME LENDING HAS PUT

Federal Reserve Chairman Ben S. Bernanke in an awkward position. In past business cycles, when the Fed raised interest rates, the impact was democratic: Companies large and small had to pay more to borrow, and so did most households. Everyone suffered.

This time around, though, most borrowers have been able to escape the Fed's interest-rate hammer. As the Fed has boosted short-term rates by more than four percentage points since 2004—the biggest move since the early 1980s—corporations and households with good credit have easily switched to long-term loans, where rates have barely budged over the past three years. "A prime borrower has options," says Robert Moulton, president of Americana Mortgage Group Inc., a Manhasset (N.Y.) mortgage broker.

Which leaves one group of Americans to absorb the brunt of tight money: families with poor credit. These typically low- to moderate-income families have always relied heavily on short-term borrowing. But they are even more vulnerable today because so many of them bought homes during the boom using subprime adjustable-rate mortgage loans (ARMs) tied to short-term interest rates. As rates have gone up, loan payments are beginning to skyrocket.

The numbers involved are enormous. About \$265 billion worth of subprime loans are scheduled to have their rates adjusted upward in 2007, estimates analyst Michael Youngblood of Friedman, Billings, Ramsey & Co. in Arlington, Va. And because money for subprime loans has dried up in recent weeks, it's going to be far harder for these borrowers to refinance. The result: Many stretched homeowners may soon be paying 11% or 12% on their mortgages, while everyone else can get 30-year fixed-rate loans at a little over 6%. That's the plight of Pamela G., a blind mother of three in Golden Valley, Minn., who is a medical transcriptionist. Her monthly payment just jumped to \$2,544 from \$2,088 and is headed higher. "Unfortunately,"



she says, "the gal did not overly explain to me that once the three years [of the teaser rate] were done, the rate would boot way up."

In effect, monetary policy is turning into a regressive tax, putting the Fed and Bernanke in a bind: If he holds rates at current levels without regard to the impact on subprime borrowers, foreclosure rates over the coming year could approach recession levels. On the other hand, if the Fed starts lowering rates to spare subprime borrowers from default, it risks letting inflation accelerate, which would harm everyone.

Most economists argue that the economy is healthy enough to withstand the problems in subprime. That's partly because the Fed's 17 rate increases have had a relatively narrow impact. Today only 28% of nonfinancial corporate debt is tied to short-term rates, much lower than in the past. Interest payments on corporate debt have risen only by \$30 billion since 2004—a pittance when profits have leapt by more than \$300 billion.

Similarly, families with better credit have been able to escape the short-term squeeze by switching to fixed-rate mortgages. Take the case of a hypothetical prime borrower who took out an ARM loan two years ago and saw the rate reset after one year. The starting rate was about 4%; it would have gone up to about 7.5%. But instead of absorbing the near-doubling of the rate, this prime borrower could refinance into a 30-year fixed-rate loan at a bit over 6%. In other words, an increase of five percentage points in the



TROUBLE Adjustable loans issued at 7% in 2005 are being reset at 10% today

Fed funds rate translated into only a two percentage-point increase in long-term rates for the homeowner.

Nor have car buyers been hit hard by the rate increases, even though the auto sector was a key channel for monetary policy in the past. According to data from the Fed, the interest rate on banks' car loans has increased by only 1.5 percentage points since 2004.

Homeowners with subprime loans aren't as lucky. Few seem to have understood their exposure to Fed rate policy when they took out their mortgages. The most popular are hybrids whose rates

stay fixed for two years, then adjust periodically over the next 28 years based on a set percentage over a short-term benchmark such as the London Interbank Offered Rate (LIBOR). Opponents call these "exploding" loans because the rates are artificially low during the two-year teaser period, then leap. In the industry, they're known as 2/28s.

ESCAPE ROUTE CLOSED

THE 2/28s NOW COMING up for their first reset were made in early 2005. It seems crazy now, but when the loans were made, nobody worried much about

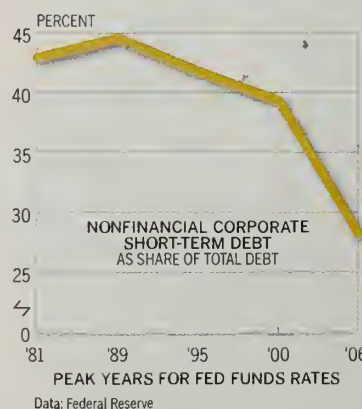
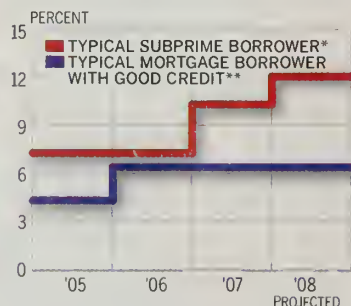
the reset. That's because, historically, 70 or 80% of two-year hybrids were paid off in the first two years. By then, rising home values would reduce the loan-to-value ratio, qualifying borrowers to refinance at lower rates. Or they would repair their credit and get a better loan. Or they would sell and move. Battling for market share, lenders didn't worry much about the long-term consequences of lax lending.

But home values are flat or falling. What's worse for many subprime borrowers, the escape route of refinancing at long-term rates is pretty much



The Short-Term Squeeze

Many subprime borrowers are stuck with adjustable-rate loans that keep rising, while mortgage borrowers with good credit have been able to take advantage of long-term, fixed-rate loans that still have low rates. Corporations also have switched to cheaper, long-term debt



d off. The reason is simple: They qualify for a 30-year fixed-rate. Bloodied subprime lenders have edly tightened their lending stan- s. What's more, the rate on a fixed rime loan is around 8.75%, which her than the teaser rate they've paying. Sure, that's less than they will soon be paying for their but they would have to apply t a new fixed-rate loan and most n't demonstrate the ability to pay 6. "They're going to be forced y with the adjusting portion of an," says Brian A. Simon, senior president of Freedom Mortgage in Mount Laurel, N.J. "It's go- o be a real challenge to a lot of wers."

ulators allowed this problem velop and only now are cracking . On Mar. 2, five of them, including ed and the Federal Deposit Insur- Corp., came out for the seemingly as: requiring lenders to go by the ped interest rate—not just the rate—in evaluating borrowers' to pay. But such tough rules will worsen the squeeze on borrowers eed to refinance.

w big is the hit from rate jumps? A l subprime loan might have been in early 2005 at 7% or so. Today, s teaser expiring, that loan might etting to 10%, which is the most owed to go up at one time. But ext time the loan resets—in six is or a year—the rate will go up based on the loan's contractual n over LIBOR. So even if short- rates stay where they are, ARM n will approach 12% in the next r so. That's way out of reach of subprime borrowers.

d the Fed, the key question is eter the stress on subprime borrow- eads to the rest of the financial te. So far, it really hasn't: Prime rge rates have actually been fall- o chances are the Fed will stay h on inflation in spite of the n to weak borrowers. Says Mark t, a New York University econo- st, I don't think the Fed is going to e monetary policy on distributionl s. Once the Fed loses its uson maintaining price stability, all d break loose." For many poor wners, it already has. ■

BusinessWeek.com

LT: To see a video report on subprime defaults and how they could affect the overall mortgage market, go to www.businessweek.com/go/tv/mortgage

MORTGAGE MELTDOWN

WHO WILL GET SHREDDED?

As the subprime business tanks, the pain is spreading to a wide swath of investors

BY MARA DER HOVANESIAN AND MATTHEW GOLDSTEIN

THE CANARIES IN THE coal mine are keeling over fast. After years of easy profits, the \$1.3 trillion subprime mortgage industry has taken a violent turn: At least

25 subprime lenders, which issue mortgages to borrowers with poor credit histories, have exited the business, declared bankruptcy, announced significant losses, or put themselves up for sale. And that's just in the past few months.

Now there's evidence that the pain is spreading to a broad swath of hedge funds, commercial banks, and investment banks that buy, sell, repackage, and invest in risky subprime loans. According to Jim Grant of *Grant's Interest Rate Observer*, the market is starting to wake up to the magnitude of the problem, entering what he calls the "recognition stage." Says Terry Wakefield, head of the Wakefield Co., a mortgage industry consulting firm: "This is going to be a meltdown of unparalleled proportions. Billions will be lost."

Hedge funds, those freewheeling, lightly regulated investment pools, seem particularly vulnerable. *BusinessWeek* has learned that \$700 million Carrington Capital and \$3 billion Greenlight Capital may have gotten badly burned because of their intricate dealings with New Century Financial, a major subprime lender whose stock has plunged 84% in four weeks amid a Justice Dept. investigations into its accounting. Magnetar Capital, a \$4 billion fund formed two years ago, may be on shaky ground, too. The question is, how many others may be suffering? "This is a very opaque industry, so no one really knows," says Mark M. Zandi, chief economist and co-founder of Moody's



Economy.com Inc. "My guess is that if you look at the top hedge funds, they're bearing most of the risk."

Not that big commercial and investment banks will go unscathed. Citigroup, HSBC, and Countrywide Financial have boosted their estimates of losses and warned of credit troubles. Sanford C. Bernstein analyst Brad Hintz predicts that the subprime meltdown will result in earnings reductions for Bear Stearns, Lehman Brothers, Goldman Sachs, Merrill Lynch, and Morgan Stanley.

Among hedge funds, Greenwich (Conn.)'s Carrington seems particularly vulnerable. Managed by ex-Citigroup banker Bruce M. Rose, the fund was launched in 2003 with \$25 million in seed

money from New Century, which owns about a 35% equity stake. Such an intimate tie between a lender and a hedge fund is highly unusual, say analysts. Carrington specializes in turning subprime mortgages into sophisticated bonds called collateralized debt obligations (CDOs) and selling them to other investors. Not surprisingly, New Century is one of Carrington's biggest suppliers, providing 17% of the loans in a recent deal. Another major supplier is Fremont General, which says it plans to exit the subprime business.

With Carrington on the verge of losing loans from two major providers, the fund, which counts Citigroup as an investor, seems to be in a bind. Rose says he expects the market for subprime loans to pick up again and is in talks with several lenders to buy mortgages. "We have no exposure to New Century as a corporate entity," he says. "Our deals have outperformed just about everything out there."

One clear loser is David Einhorn, manager of hedge fund Greenlight Capital, who made a big, ill-timed gamble on the subprime sector when he fought his way onto New Century's board last March. Greenlight, which regularly posts double-digit annual gains, is down about 2.5% on the year; its stake in New Century, valued at \$109 million at the start of the year, has shrunk to \$21 million. Einhorn's seat on New Century's board prohibited him from selling even as the lender warned that it would restate most of its 2006 earnings results and said federal prosecutors are investigating its accounting. Einhorn, through

a spokeswoman, declined to comment.

Some on Wall Street point out that Magnetar showed bad timing, too, by entering the subprime arena last year just as the underwriting quality of subprime loans began to deteriorate rapidly (table). For now, Magnetar isn't showing any outward signs of trouble. A person familiar with the fund says it took steps to minimize its exposure to the subprime market, and a Magnetar spokesman says the fund is doing well.



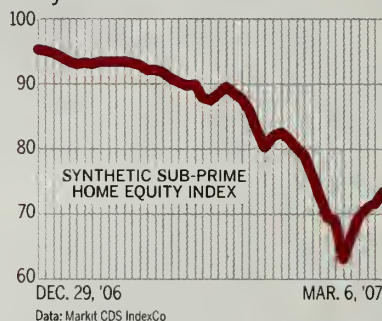
GREENLIGHT'S EINHORN His fund could be hard hit

Other hedge funds that have feasted on mortgage-backed securities will be hit hard if rating agencies start downgrading them, as is widely expected. That would be likely to send their values plummeting. "This is indeed a stress scenario," says Glenn T. Costello, co-head of the residential MBS Group at Fitch Ratings Inc. Kevin J. Kanouff, who heads bond surveillance for Clayton Holdings Inc., a consulting firm for institutional investors, adds that "hedge funds are getting very nervous about their investments."

But those downgrades likely won't come right away. Observers say ratings agencies may rely on some models that don't fully account for the recent explosion in exotic mortgages, such as interest-only loans. Says Susan Barnes, managing director in the U.S. residential

SUBPRIME SELL-OFF

An index that tracks the riskiest subprime loans has nosedived this year



mortgage-backed securities group of Standard & Poor's, while *BusinessWeek*, unit of The McGraw-Hill Companies: "models are continually adjusted and hanced." Adds Fitch Costello: "There's a clear trend that we expected higher losses."

Commercial investment banks lost many tendrils in mortgage business too. They earned

fees during the housing boom by packaging loans into pools and selling them to investors. That market is shrinking as prime lenders and investors pull out, leaving banks holding risky loans.

UP THE FOOD CHAIN

THERE'S ALSO growing talk that rating firms, in particular Goldman Sachs Global Vantage Inc., incurred steep losses in trades based on the ABX subprime index (chart). Market makers, the big banks were forced to take the other side of clients' trades, or bets that the index would rise. When the index plunged 34% in the 10 weeks of the year, the banks lost. Costello, who reports first-quarter earnings on Mar. 13 and is a big player in the market, declined to comment.

In another case of dreadful timing, Citigroup disclosed on Feb. 28 that it recently upped its stake in New Century to over 5%, adding some 1 million shares just weeks before New Century revealed the investigation by federal prosecutors. Citigroup declined to comment.

The biggest fear is that the trouble will move up the food chain. The questionable lending practices that were used for subprime mortgages during the boom were also used for regular "prime" mortgages—among them zero downpayments, loose loan-to-value ratios, and exotic mortgages with low up-front payments that balloon over time. While subprime loans accounted for about 10% of mortgages originated last year, Liu of UBS estimates that fully 60% of last year's loans are "showing signs of stress." Says Nouriel Roubini, economics professor at New York University's Stern School of Business: "The risk that prime borrowers will feel financial stress in 2007 cannot be underestimated." ■

—With Spencer E. Ante in New York

Ticking Time Bombs?

Changes in the mortgage industry since 2000 have increased the risks to investors of mortgage-backed securities.

EQUITY CASH-OUTS

Homeowners tapped \$900 billion in equity from 2000 to 2005. If home prices keep falling, many will owe more than their homes are worth—and defaults could spike.

SILENT SECONDS

Many subprime borrowers used "silent" second mortgages from different lenders to refinance and cash out equity. No one tracks the extent of borrowers' obligations.

LAX UNDERWRITING

In 2006, 38% of all subprime loans required no money down. Some 60% of subprime loans required no or low documentation.

UNTESTED MODELS

The ratings agencies that assess mortgage-backed securities may use models that don't fully account for many new types of exotic mortgages.

Data: "How Resilient Are Mortgage Backed Securities to Collateralized Debt Obligation Market Disruptions?" by Joseph R. Mason, Drexel University, and Joshua A. Rosner, Graham Fisher & Co., First American LoanPerformance

EXECUTIVE COMPENSATION

THE SEC IS EYEING INSIDER STOCK SALES

BusinessWeek has learned it is examining possible abuses in automatic trading plans

JANE SASSEEN

ARE EXECUTIVES using inside information to boost returns when they sell stock through automatic trading plans? That is the conclusion reached in the first academic study of such plans, as reported by *BusinessWeek* on Dec. 18. Troubled by those results, now the Securities & Exchange Commission is looking more closely at such plans and whether the rules governing them need to be tightened, *BusinessWeek* has learned. Anyway the plans are being used "isn't they were supposed to work," said a source familiar with the agency's views. The move comes as broader concerns have grown regarding prearranged trading plans, known as 10b5-1 plans, since the 2000 rule that created them. Some investors have begun to track them more closely. And revelations about two founders of New Century Financial Corp., the mortgage firm whose stock collapsed after an announcement it would restate earnings, could raise new questions about such sales: Some months before, the pair sold shares worth \$26 million through trading plans.

The SEC's goal in creating automatic trading plans was to allow executives to sell shares without triggering insider trading charges. To gain that legal "safe harbor," however, executives must meet certain conditions. They must set up a trading plan when they don't know of any significant nonpublic information, at the dates or prices at which trades will be made in advance, and give up control of the trades to a broker.

Those limited rules allow executives some maneuvering room to time sales



than is generally understood. According to the study by Alan D. Jagolinzer, an assistant professor at the Stanford University Graduate School of Business, executives selling shares through 10b5-1 plans do substantially better than would be expected if trading were truly automatic. In a study of roughly 117,000 trades made by 3,426 executives at 1,241 companies, trades made inside plans beat the market by 6% over six months, while those at the same firms who traded outside of plans only topped it by 1.9%.

More often than not, sales made through plans by insiders occur ahead of a stock drop. The rules also allow executives to end plans before they've been fully executed, set up multiple short-term plans, and begin selling immediately after adopting a plan. "I wouldn't have thought the plans allowed this much flexibility," says a source familiar with Jagolinzer's study. "His work clearly raises questions about the trading strategies people are using and if they are going well beyond what was envisioned."

The report has prompted the SEC to undertake a more detailed analysis of 10b5-1 plans. If the commission

eventually concludes that problems exist, it could change how it evaluates cases for potential enforcement action; it could also propose tightening the rules governing such trades. Greater public disclosure of an executive's trading strategy, or of the dates when a plan is started or ended, might be required. H. Nejat Seyhun, a finance professor at the University of Michigan's Ross School of Business, also thinks stiffer trading controls are needed:

Sales might be banned until six months after a plan is put into effect, for example, or an executive who ends a plan prematurely or makes other changes might lose the safe harbor protection.

The SEC's enforcement officials are also keeping a close eye on 10b5-1 trades, although the agency has yet to challenge a plan by bringing an insider trading case against an executive with one in place. And growing questions about the plans could be fueled by the trades made at New Century.

Its shares have plummeted to around \$5 in the wake of a Mar. 2 announcement that federal prosecutors are probing its accounting, as well as looking at trading in its securities following New Century's warning in early February that it would have to restate 2006 earnings. Between August and November of last year, two founders, Robert Cole and Edward Gotschall, sold roughly 650,000 shares, at prices averaging just below \$40, through automatic trading plans. The company declined to comment. Prosecutors and the SEC would not comment on whether those trades are among those being probed.

Some investors, too, appear to be paying closer attention to such plans. Gradient Analytics Inc., an independent research firm, warned clients last year to steer clear of companies with overly aggressive automatic trading plans. Now it regularly analyzes such plans in recommending stocks to buy or sell. "Plans being instituted are becoming more creative," says Carr Bettis, a former finance professor who co-founded Gradient. "They've been around long enough for people to find ways to use them to their advantage." ■

COMMENTARY

BY MICHAEL MANDEL

The Real Threat Isn't Housing

If productivity growth keeps sliding, a widespread crisis could be next



THE QUICKEST WAY TO get run over is to look the wrong way when you cross the street. Right now everyone is worrying—or obsessing—about a potential housing bust. And why not? You can hear the screams issuing from California to Florida as subprime borrowers and lenders take it on the chin. **J** But the biggest danger is not the housing decline, however painful it might be. Instead, an

18-wheeler that threatens to flatten the economy and the financial markets is barreling at us from another direction altogether: weak productivity growth.

On Mar. 6, the Bureau of Labor Statistics announced that nonfarm business productivity rose by only 1.6% in 2006, its smallest gain since 1997. And more bad news was buried deep in the report: Productivity gains for 2005 and 2004 were revised down as well.

Investors shrugged off those numbers, sending the stock market up 1.5% that day for the biggest gain since July, responding to a rise in Asian markets and reassuring words from Treasury Secretary Henry Paulson. But if productivity growth continues its three-year slide, the U.S. will be vulnerable to a widespread recession or financial crisis that dwarfs any damage from the housing slump. Like a family living large that has to cut back, Americans will find that all of the bills put off for years will come due.

Consider the facts. Since 1995, when the New Economy and the information revolution really took hold, gains in productivity (output per hour) have averaged about 2.7% per year. That's a full percentage point higher than the preceding two decades.

Faster productivity growth means that the annual output of the economy today is about 10%, or \$1.2 trillion, bigger than it would have been at the previous anemic pace. That additional output is more than enough to pay for the war in Iraq, which is costing \$100 billion to \$150 billion per year, and for the entire \$767 billion annual cost of home construction and renovation in 2006. And you'd still have some spare billions left over.

In short, the productivity acceleration the past 10 years has created a total of \$1.2 trillion in extra output since 1995, measured in 2006 dollars. That helps explain why American households, taken together, are so much richer than they were: Household nonhousing net worth, adjusted for inflation and federal debt, has soared by almost \$1.2 trillion over the same period, despite the dot-com debacle that crashed the market.

The massive amount of additional output is a key reason why the U.S. economy has not faced upward pressure on prices. Good productivity gains gave the economy enough momentum to fight off the disasters of 2001—the terrorist attacks, the stock market crash, the collapse of Enron—with only a minimal recession.

But the bonanza starts to disappear if productivity growth drops much further below its current level. Such a decline is a lot more possible than most economists realize or are willing to accept. History shows that shifts in the long-term trends of productivity are essentially unpredictable. No economic forecaster

as far as I know, foretold the productivity acceleration of the mid-1990s. And nobody, predicted the productivity slowdown of the 1970s, which ignited years of high inflation.

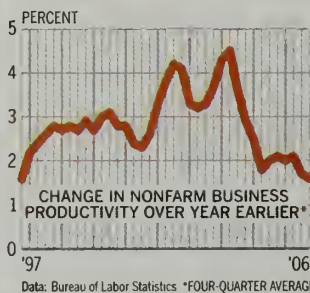
What are the warning signs that the productivity revolution might be flagging? One is the decline in business investment in the fourth quarter of 2006, combined with a drop in new orders for nondefense, non-aerospace capital goods in January. This could be due to the housing slump, or it could be because companies are seeing fewer good investment opportunities, at least in the U.S.

Another disturbing indicator would be an unexpectedly high increase in jobs over the next few months. If companies run into productivity problems, their first response would be to hire more workers to meet demand. Finally, the biggest red flag would be a sharp fall in corporate profits that lasts more than one quarter, just as a precursor to the 1980s. The Economy was a sharp rise in profits.

I have no crystal ball when it comes to productivity; no one does. But when you hear that tractor-trailer blow its air horn, it's a good idea to pay attention. ■

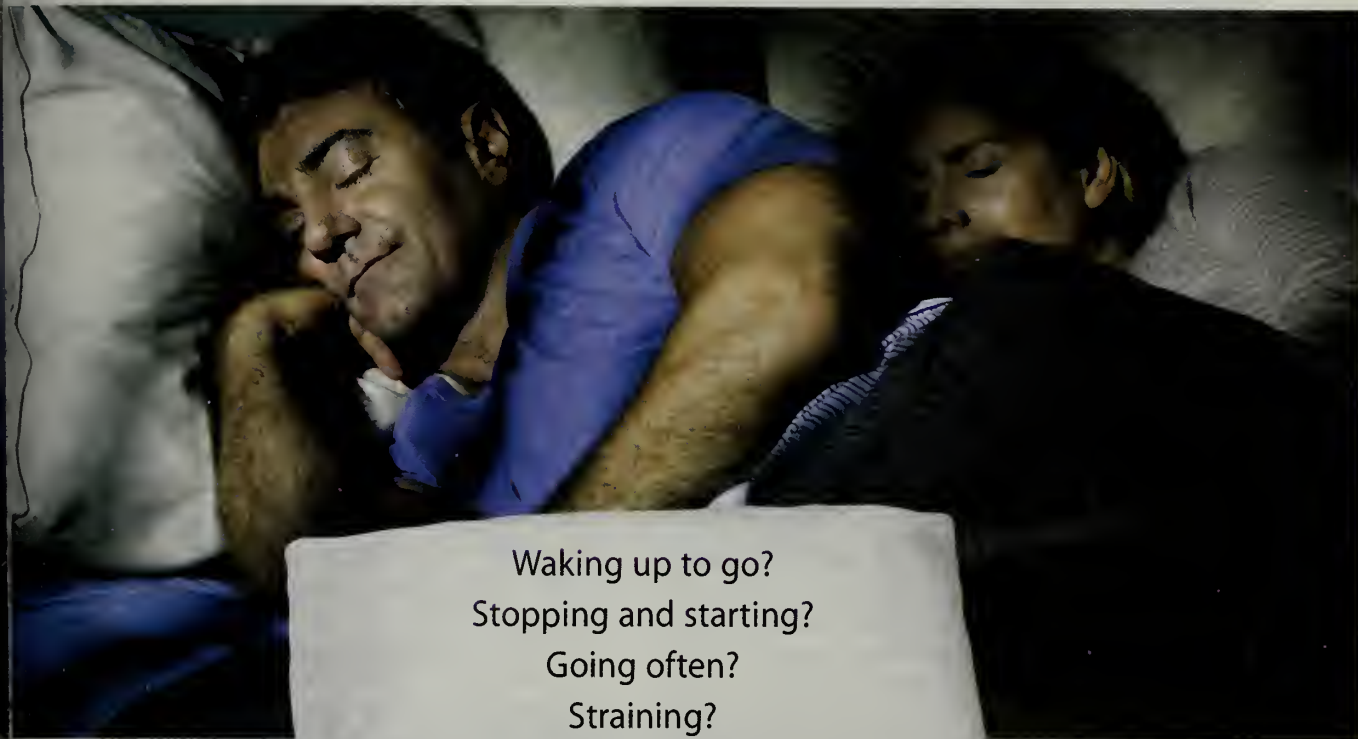


THE PRODUCTIVITY SLOWDOWN



Guys, want to take fewer trips to the bathroom at night?

FLOMAX may improve male urinary symptoms due to BPH in **1 WEEK**.



Waking up to go?
Stopping and starting?
Going often?
Straining?
Going urgently?
Weak stream?

Talk to your doctor. For many men, FLOMAX may help in one week.

FLOMAX is approved to treat male urinary symptoms due to BPH, also called enlarged prostate.

Only your doctor can tell if your symptoms are due to BPH and not another condition such as

prostate cancer. Common side effects are runny nose, dizziness and decrease in semen.

A sudden decrease in blood pressure may occur upon standing, rarely resulting in fainting.

Avoid situations where injury could result. If considering cataract surgery, tell your eye

surgeon you've taken FLOMAX. **To learn more, call 866-432-9734 or visit 4FLOMAX.com.**

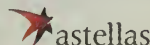
If you can't afford FLOMAX, our Patient Assistance Program may help. Call 800-556-8317.

FLOMAX[®]
TAMSULOSIN HCl CAPSULES 0.4 MG

The 1-week difference.

Please see Patient Information on adjacent page.

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FLOMAX[®]

TAMSULOSIN HCl CAPSULES 0.4 MG

IMPORTANT PATIENT INFORMATION

What is FLOMAX?

FLOMAX is a prescription medication that is specifically designed to help relieve the signs and symptoms of *benign prostatic hyperplasia (BPH)*, a condition your physician may refer to as an enlarged prostate. FLOMAX works by relaxing the prostate muscles around the urethra, allowing urine to flow more freely out of the bladder. FLOMAX is NOT indicated for the treatment of high blood pressure.

Who should not use FLOMAX?

You should not take FLOMAX if you are allergic to tamsulosin hydrochloride or any other component of FLOMAX.

What should I be aware of before taking FLOMAX?

- o An enlarged prostate (BPH) and cancer of the prostate cause many of the same symptoms. It is important that you see your doctor first to rule out prostate cancer.
- o Though extremely rare, FLOMAX and other drugs in this class (alpha-1 blockers) have been associated with prolonged painful erection (priapism), which is unrelieved by sex. If this occurs, seek immediate medical attention, since this condition can lead to permanent inability to have an erection, if left untreated.
- o During cataract surgery, a condition known as intraoperative floppy iris syndrome (IFIS) has been observed in patients treated with drugs in this class. When considering cataract surgery, inform your surgeon if you are taking or have taken FLOMAX and/or other drugs in this class.
- o If you have had a serious reaction to sulfa, be sure to tell your doctor before taking FLOMAX.
- o FLOMAX should NOT be used in combination with other drugs in its class since interactions may be expected.
- o FLOMAX should be used with caution in combination with cimetidine or with warfarin (a drug often prescribed under the brand name Coumadin[®] [Bristol-Myers Squibb Company]).

Are there any warnings associated with the use of FLOMAX?

FLOMAX may cause a sudden drop in blood pressure, especially following the first dose or when changing doses. Although rare, this drop in blood pressure may be associated with fainting, lightheadedness or dizziness. Caution should be

exercised when driving, operating machinery, or performing hazardous tasks, since injury could result.

What are the most common side effects of FLOMAX?

The most common side effects are dizziness, runny nose, and a decrease in semen. Other side effects include headache and tiredness.

How should I take FLOMAX?

FLOMAX 0.4 mg capsules are taken once daily. FLOMAX should be taken approximately one-half hour after the same meal each day. If you stop or forget to take FLOMAX for several days, start again with the 0.4 mg once-daily dose. If you were previously on a higher dose, contact your doctor before returning to the higher dose.

Do not crush, chew, or open FLOMAX capsules.

What about overdosing with FLOMAX?

You should always take your medications according to the directions given by your doctor. If you think you have taken an overdose of FLOMAX capsules, contact your doctor immediately.

Still have questions?

For more information, ask your doctor or pharmacist, call 1-866-432-9734, and/or visit www.4FLOMAX.com.

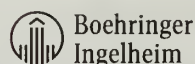
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TOS

WHY HYBRIDS ARE SUCH A HARD SELL

They haven't crossed over to the mainstream

DAVID WELCH

GIVEN ALL THE BUZZ about hybrids, not to mention the greening of the citizenry, you'd think they would be easy to sell. They're not. After growing nicely through 2006, hybrid sales began to slow this year. The gasoline-electric vehicles now make up 1.8% of all vehicle sales, says Edmunds.com, down from a high of 2.1% in October.

The major reason is that hybrids typically cost \$3,000-plus more than conventional cars. As a result, automakers in recent weeks have been slashing prices. Less than a year ago, Toyota dealers got full price for the Prius. Now you can immediately lease one for a slim \$219 a month. Ford Motor Co. is also cutting the price of its test version of its Escape hybrid. In February, carmakers spent an average of \$1,500 on incentives per hybrid, says Edmunds—triple what they laid out in January.

The discounting helped the likes of Toyota Motor Corp. and Ford post decent sales in February, but, as the Big Three know all

too well, ladling out incentives is no way to make decent profits. Making matters worse, just as hybrid sales start slowing, automakers are gearing up to launch a slew of new models. At least 30 hybrids will hit the market in the next 20 months. That will bring the number to more than 40, up from 12 today, says Boston research firm Global Insight. "Now that the automakers have tapped the early adopters, they're going after the mass market," says Jesse Toprak, an Edmunds analyst. "For consumers, the answer is often no."

TAILING OFF

A FEW YEARS AGO, automakers decided to put hybrid technology in regular models. The hope was to move beyond the geek chic of the Prius and win over everyone else. Hybrid would be another option, like, say, navigation. If enough people bought hybrids, carmakers figured, they would achieve sufficient economies of scale to eliminate the big premium over conventional models.

That hasn't happened. And some models have suffered badly. Honda Motor Co. sold 70% fewer hybrid Accords in 2006; Toyota has sold 24% fewer Lexus RX 400h sport-

utility vehicles so far this year. The fuel savings are simply too puny to offset the hybrid premium. With gas at \$2.50 a gallon, it would take 10 years to recoup the extra \$3,000 cost of the Accord hybrid.

Honda and Toyota are trying to have it both ways: putting the technology in regular models while coming up with new hybrid-only cars that, like the Prius, confer instant *über-greenness*. Lexus is considering one, and Honda plans a subcompact.

Getting prices down—and not by discounting—is the long-term solution. That means finding a way to make the cars more cheaply. Batteries account for about half the hybrid premium. But cheaper lithium ion cells won't appear for several years. Cutting costs further requires achieving those elusive economies of scale, which means building and selling more hybrids. That's Toyota's strategy; it hopes to sell 160,000 Priuses this year, up from 107,000 in 2006.

Pulling that off will require deft marketing, especially since the government this fall will start requiring a more accurate measure of fuel economy. The Prius' claimed 55 mpg will likely drop to a less compelling 46 mpg. Both Toyota and Ford are planning major advertising campaigns. And discounts on all hybrids are here to stay for a while.

Look closely and you can see the automakers hedging their bets. Toyota is pushing into diesel. Ditto for Honda, which may not build a new hybrid Accord. Nissan is waiting to see how its hybrid Altima does before putting the technology into other vehicles. Honda's planning chief for North America, Dan Bonawitz, likely speaks for most of his counterparts when he says: "There won't be a giant surge in hybrid sales unless there's an oil crisis." ■

A Case of Sticker Shock

Hybrids are losing traction because they cost more than their conventional siblings

NISSAN ALTIMA HYBRID

+\$4,000



FORD ESCAPE HYBRID

+\$3,000



HONDA ACCORD HYBRID

+\$3,300





SCANDALS

FROM STARMAKER TO SCAMMER?

Boy band Svengali Lou Pearlman is accused of running a Ponzi scheme

BY CHRISTOPHER PALMERI

LOUIS J. PEARLMAN SEEMED to have it all. He lived in a \$12 million, Italian-style mansion in Orlando and was chauffeured around in a powder-blue Rolls-Royce. His office, part of a sprawling downtown complex he owned, was lined with the gold and platinum records he earned as creator of pop music sensations *NSYNC and the Backstreet Boys.

Now, all that could go—in the words of *NSYNC—bye, bye, bye. The Florida Office of Financial Regulation has charged Pearlman, 52, with orchestrating a Ponzi-like scheme that may have bilked some 1,800 investors out of \$317 million. The FBI has raided his house and office, banks have begun seizing assets, and dozens of investors have launched civil suits. Pearlman, who said in a Feb. 2 letter to the *Orlando Sentinel* that he was in Germany promoting his musical ensemble US5, couldn't be reached for comment.

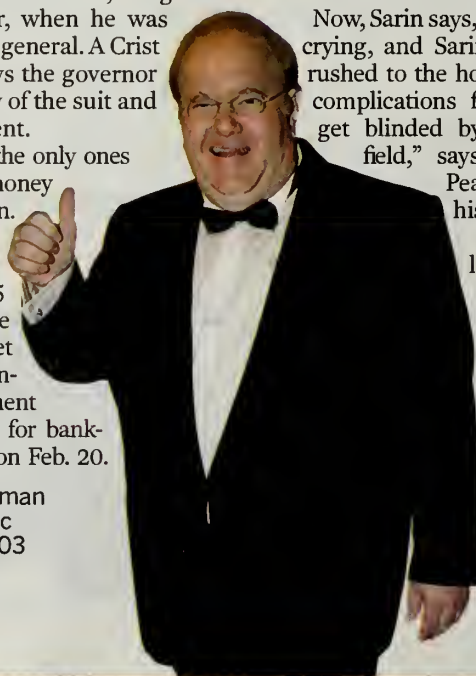
The accusations center on money-market-like investments sold by Pearlman's main company, Trans Continental Airlines Inc., a charter carrier. The accounts offered interest rates slightly higher than what its investors, many of them Florida retirees, could get at a local bank. According to the Florida complaint,

Pearlman allegedly distributed brochures highlighting coverage by the Federal Deposit Insurance Corp., and he talked up insurance from American International Group Inc. and Lloyd's of London. Florida regulators say none of that was true.

Pearlman's recent legal troubles have also hit new Florida Governor Charles J. Crist Jr., who was named as a defendant in a Mar. 5 investor suit. The suit claims Crist, a Republican, didn't pursue complaints about Pearlman, a big campaign contributor, when he was Florida's attorney general. A Crist spokeswoman says the governor hasn't seen a copy of the suit and would not comment.

Retirees aren't the only ones trying to get money out of Pearlman. Bank of America Corp. has an outstanding \$25 million mortgage on Church Street Station, his downtown entertainment complex that filed for bankruptcy protection on Feb. 20.

IMPRESARIO Pearlman at a German music awards gala in 2003



***NSYNC IN 2001**
Band members sued Pearlman over his handling of their money

This year, Washington Mutual Inc. v a \$9.7 million judgment against Pearlman over a defaulted loan

The son of Flushing (N.Y.) dry cleaner, Pearlman raised red flags with his business activities before. Both the Backstreet Boys and *NSYNC sued him in the late 1990s, claiming he misappropriated money. Those suits were settled. Last year pop star Justin Timberlake, the former lead singer of *NSYNC, told *Rolling Stone* that he had "been repeatedly raped by a Svengali," referring to Pearlman. Timberlake's publicist did not respond to a request for comment.

'EVERYTHING'S FINE'

FOR DON SELIGMAN, the leasing agent for Church Street Station, the first warning came last November, when Florentino Vasquez, a vice-president for operations at Pearlman's company, asphyxiated himself in his garage: "I think that was the precursor. He knew what was coming."

Manhattan dentist Steven Sarin was simply blindsided. Sarin's partner first invested with Pearlman in 1997, after hearing about the good return from another resident of their Florida retirement community. Sarin's father-in-law handed over much of their life savings to Pearlman. Sarin says Pearlman frequently visited the family, even inviting his parents on their birthdays. Sarin was invited to Pearlman's parties, featuring his acts. In December, Pearlman served corned beef sandwiches at a dinner in Queens. Sarin and his brother called Pearlman about their investments. Sarin said: "Everything's fine," Sarin recalled. "The business is doing phenomenally well."

Now, Sarin says, his mother can't stop crying, and Sarin himself had to be rushed to the hospital on Feb. 2 after complications from stress. "Pearlman got blinded by the entertainment field," says Sarin, who was not involved in the family's money.

Pearlman would not comment on his family's money. For now, the little hope of Gerard A. McHale, who was appointed by a Florida judge to oversee Pearlman's businesses in February, says he has recovered \$50,000 so far. He adds, "I don't know how I'm going to get paid." ■

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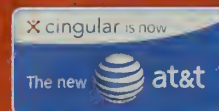
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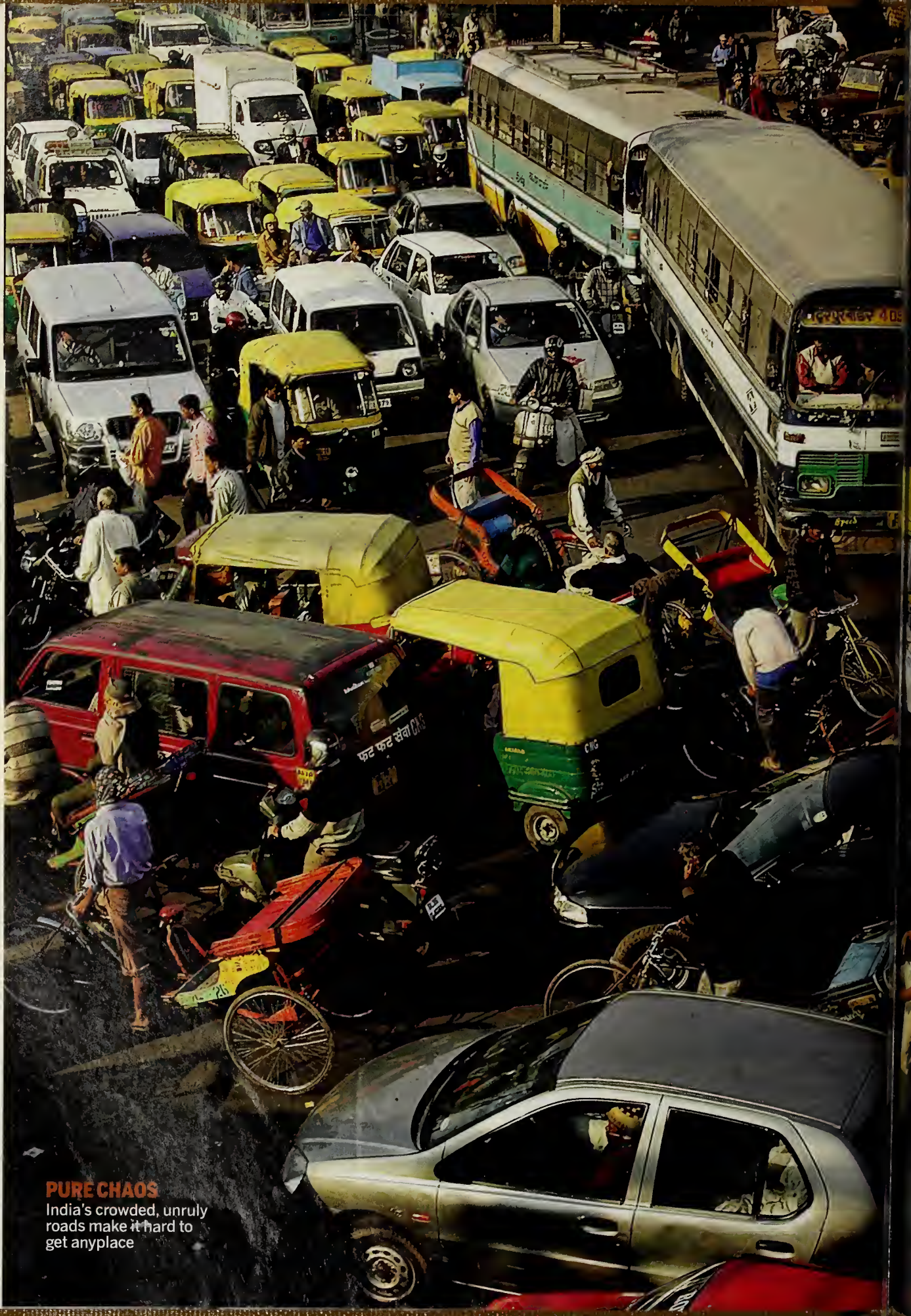
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PURE CHAOS

India's crowded, unruly roads make it hard to get anywhere

The Trouble With India

Crumbling roads, jammed airports, and power blackouts could hobble growth

BY STEVE HAMM

When foreigners say Bangalore is India's version of Silicon Valley, the high-tech office park called Electronics City is what they're often thinking of. But however much Californians might hate traffic-clogged Route 101, the main drag through the Valley, it has nothing on Hosur Road. This potholed, four-lane stretch of gritty pavement—the primary access to Electronics City—is pure chaos. Cars, trucks, buses, motorcycles, taxis, rickshaws, cows, donkeys, and dogs jostle for every inch of the roadway as horns blare and brakes squeal. Drivers run red lights and jam their vehicles into any available space, paying no mind to pedestrians

EYEPRESS; ILLUSTRATION BY LAUREL DAUNIS-ALLEN/BW

clustered desperately on median strips like shipwrecked sailors. Pass through the six-foot-high concrete walls into Electronics City, though, and the loudest sounds you hear are the chirping of birds and the whirr of electric carts that whisk visitors from one steel-and-glass building to the next. Young men and women stroll the manicured pathways that wend their way through the leafy 80-acre spread or coast quietly on bicycles along the smooth asphalt roads.

With virtually no mass transit in Bangalore, Indian technology firm Infosys Technologies Ltd. spends \$5 million a year on buses, minivans, and taxis to transport its 18,000 employees to and from Electronics City. And traffic jams mean workers can spend upwards of four hours commuting each day. "India has underinvested in infrastructure for 60 years, and we're behind what we need by 10 to 12 years," says T.V. Mohandas Pai, director of human resources for Infosys.

India's high-tech services industry has set the country's economic flywheel spinning. Growth is running at 9%-plus this year. The likes of Wal-Mart, Vodafone, and Citigroup are placing multibillion-dollar bets on the country, lured by its 300 million-strong middle class. In spite of a recent drop, the

Bombay stock exchange's benchmark Sensex index is still up more than 40% since June. Real estate has shot through the roof, with some prices doubling in the past year.

But this economic boom is being built on the shakiest of foundations. Highways, modern bridges, world-class air-

ports, reliable power, and clean water are in desperately short supply. And what's already there is literally crumbling under the weight of progress. In December, a bridge in eastern India collapsed, killing 34 passengers in a train rumbling underneath. Economic losses from congestion and poor roads alone are as high as \$6 billion a year, says Gajendra Haldea, an adviser to the federal Planning Commission.

For all its importance, the tech services sector employs just 1.6 million people, and it doesn't rely on good roads and bridges to get its work done. India needs manufacturing to boom if it is to boost exports and create jobs for the 10 million young people who enter the workforce each year. Suddenly,



NEW VS. OLD

Infosys' ultramodern Bangalore campus; a poor neighborhood stands in the shadow of its pyramid

good infrastructure matters a lot more. Yet industry is hobbled by overcrowded highways where speeds average just 20 miles per hour. Some ports rely on armies of laborers to unload cargo from trucks and lug it onto ships. Across the state of Maharashtra, major cities lose power one day a week to relieve pressure on the grid. In Pune, a city of 4.5 million, it's lights out every Thursday—forcing factories to maintain expensive backup generators. Government officials were shocked last year when Intel Corp. chose Vietnam over India as the site for a new chip assembly plant. Although Intel declined to comment, industry insiders say the reason was largely the lack of reliable power and water in India.

Add up this litany of woes and you understand why India exports total less than 1% of global trade, compared with 10% for China. Says Infosys Chairman N.R. Narayana Murthy, "If our infrastructure gets delayed, our economic development, job creation, and foreign investment get delayed. Our economic agenda gets delayed—if not derailed."

The infrastructure deficit is so critical that it could prevent India from achieving the prosperity that finally seems within its grasp. Without reliable power and water and a modern transportation network, the chasm between India's

moneyed elite and its 800 million poor will continue to widen, potentially destabilizing the country. Jagdish N. Bhagwati, a professor at Columbia University, figures that India's gross domestic product would run two percentage points higher if the country had decent roads, railways, and power. "It's bursting at the seams," says

Jack and Suzy Welch on investing in China vs. India, page 110

Building The Future

The upgrading of India's infrastructure is moving ahead in fits and starts. Here are some key projects:



1 Delhi Metro

Phase I of the system was completed on budget and ahead of schedule. Foreign players: South Korea's Rotem, subway cars; the U.S.'s Parsons Brinckerhoff, management.

2 Golden Quadrilateral

This \$12 billion project connecting India's major cities is nearly finished. Foreign contractors: the U.S.'s Louis Berger Group, the Netherlands' DHV International.

3 Dabhol Power Plant

The plant was for Enron, which was forced to bow out. Foreign contractors: Indian management. Foreign participants: U.S.'s GE and I



Nath, India's Commerce & Industry Minister. Without infrastructure, "we can't continue with the growth rates we've had."

The problems are even contributing to overheating in the economy. Inflation spiked in the first week of February to a year high of 6.7%, due in part to bottlenecks caused by the country's lousy transport network. Up to 40% of farm produce rot because it rots in the fields or spoils en route to consumers, which contributes to rising prices for staples such as lentils and onions.

India today is about where China was a decade ago. Back in 1997, China's economy was shifting into overdrive, but its roads and power grid weren't up to the task. So Beijing launched a massive upgrade initiative, building more than 25,000 miles of highways that now crisscross the country and are as good as the best roads in the U.S. or Europe. India, by contrast, has

just 3,700 miles of such highways. It's no wonder that when foreign companies weigh putting new plants in China vs. India to produce global exports, China more often wins out.

China's lead in infrastructure is likely to grow, too. Beijing plows about 9% of its GDP into public works, compared with New Delhi's 4%. And because of its authoritarian government, China gets faster results. "If you have to build a road in China, just a handful of people need to make a decision," says Daniel Vasella, chief executive of pharmaceutical giant Novartis. "If you want to build a road in India, it'll take 10 years of discussion before you get a decision."

Blame it partly on India's revolving-door democracy. Political parties typically hold power for just one five-year term before disgruntled voters, swayed by populist promises from the opposition, kick them out of office. In elections last year in the state of Tamil Nadu, for instance, a new government was voted in after it pledged to give free color TVs to poor families. "In a sanely organized society you can get a lot done. Not here," says Jayaprakash Narayan, head of Lok Satta, or People Power, a national reform party.

Then there's "leakage"—India's euphemism for rampant corruption. Nearly all sectors of officialdom are riddled with graft, from neighborhood cops to district bureaucrats to state ministers. Indian truckers pay

5 Bangalore Intl. Airport

The \$430 million airport is due to be completed in April, 2008. Foreign Players: Germany's Siemens, engineering; Switzerland's Unique, operations.

6 Vallapardam container terminal

Work on the \$555 million container transshipment facility, which will serve the southern port of Kochi, began in 2005. Foreign player: Dubai's DP World.

tech office
outskirts of
is home to
Western and
companies. Key
Microsoft, IBM,



SLOW AND FAST

India's rail system is an anachronism. But New Delhi's subway system finished its first phase in 2005 on budget and ahead of schedule

about \$5 billion a year in bribes, according to the watchdog group Transparency International. Corruption delays infrastructure projects and raises costs for those that move ahead.

Fortunately, after decades of underinvestment and political inertia, India's political leadership has awakened to the magnitude of the infrastructure crisis. A handful of major projects have been completed; others are moving forward. Work on the Golden Quadrilateral—a \$12 billion initiative spanning more than 3,000 miles of four- and six-lane expressways connecting Mumbai, Delhi, Kolkata, and Chennai—is due to be completed this year. The first phase of a new subway in New Delhi finished in late 2005 on budget and ahead of schedule. And new airports are under construction in Bangalore and Hyderabad, with more planned elsewhere. “We have to improve the quality of our infrastructure,” Prime Minister Manmohan Singh told a gathering of tech industry leaders in Mumbai on Feb. 9. “It’s a priority of our government.”

Singh, in fact, is promising a Marshall Plan-scale effort. The government estimates public and private organizations will chip in \$330 billion to \$500 billion over the next five years for highways, power generation, ports, and airports. In addition, leading conglomerates have pledged to overhaul the retailing sector. That will require infrastructure upgrades along the entire food distribution chain, from farm fields to store shelves.

Envisioning a brand-new India is the easy part; paying for



it is another matter. By necessity since the country's public debt stands at 82% of GDP, the 111th worst ranking in the world, much of the money for these new projects will have to come from private sources. Yet India captured only \$8 billion in foreign direct investment last year, compared with China's \$63 billion. “Having grandiose plans isn't enough,” says Yale University economics professor T.N. Srinivasan.

Just about every foreign company operating in India has a horror story of the hardships of doing business there. No. 1 Corp. saw thousands of its cellular phones ruined last October when a shipment from a factory in Chennai was soaked by rain because there was no room to warehouse the crates of handsets at the local airport. Japan's Maruti Suzuki says trucking its cars 900 miles from a factory in Gurgaon to the port in Mumbai can take up to 10 days. That's partly due to delays at the three state borders along the way, where drivers are stalled as officials check their papers. But it's also because big rigs are barred from India's congested cities during the day, when they might bring dense traffic to a standstill. Once at the port, a Japanese company's autos must wait weeks for the next outbound ship because there's not enough dock space for cargo carriers to load and unload.

India's summer monsoon wreaks havoc, too. Even relatively light rains can choke sewers, flood streets, and paralyze a city, while downpours are devastating. Two years ago, Florida-based contract manufacturer Jabil Circuit Inc. saw shipments of computers and networking equipment from its plant near Mumbai delayed for five days after an storm. “In our business, five days is a really long time,” says William D. Muir Jr., who oversees Jabil's Asian operations.

Companies often have no choice but to make the best of a bad situation. Cisco Systems Inc., the American network equipment giant, has had a research and development office

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MORE ON INDIA'S INFRASTRUCTURE DEFICIT

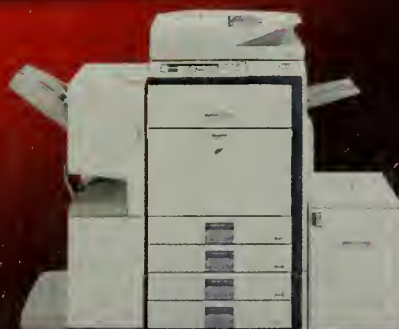
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CoverStory

India since 1999 and already has 2,000 engineers in the country. To supply the country's fast-growing telecommunications industry, Cisco decided last year to try its hand at making some parts locally. In December it contracted with another company to build Internet phones in the southeastern city of Chennai. Although Cisco says the quality of the workmanship is up to snuff, it has to fly parts in because the ports are so slow—and getting them to the factory right when they're needed is proving nettlesome. "We believe in manufacturing in India, but we don't believe in logistics in India—yet," says Wim Elfrink, Cisco's chief globalization officer. Elfrink adds that unless the Chennai operation demonstrates it can run as efficiently as Cisco setups elsewhere, it won't go into full production as planned this summer.

Even the world's largest maker of infrastructure equipment is constrained by India's feeble underpinnings. General Electric Co. last year sold \$1.2 billion worth of gear such as power generators and locomotives in India, more than double what it billed in 2005. To meet that surging demand, it is scrambling to find a location where it can manufacture locomotives in partnership with India Railways. But when GE dispatched three employees to survey a potential site the railway favored in the northern state of Bihar, the trio returned discouraged. It took five hours to drive the 50 miles from the airport to the site, and when they got there they found...nothing. "No roads, no power, no schools, no water, no hospitals, no housing," says Pratyush Kumar, president of GE Infrastructure in India. "We'd have to create everything from scratch," including many miles of railroad tracks to get the locomotives out to the main lines.

But there is a silver lining for GE and other international giants: India's infrastructure deficit could yield huge opportunities. American executives who traveled to India last November on the largest U.S. trade mission ever were tantalized by the possibilities. Jennifer Thompson, director of international planning at Oshkosh Truck Corp., viewed construction projects where swarms of workers carried wet concrete in buckets to be poured. That told her there's



TEAM EFFORT

Bangalore's new airport takes advantage of a law permitting public-private partnerships

great potential in India for selling Oshkosh mixer trucks. "There are infrastructure challenges, but we see a lot of opportunities to help them meet those challenges," she says.

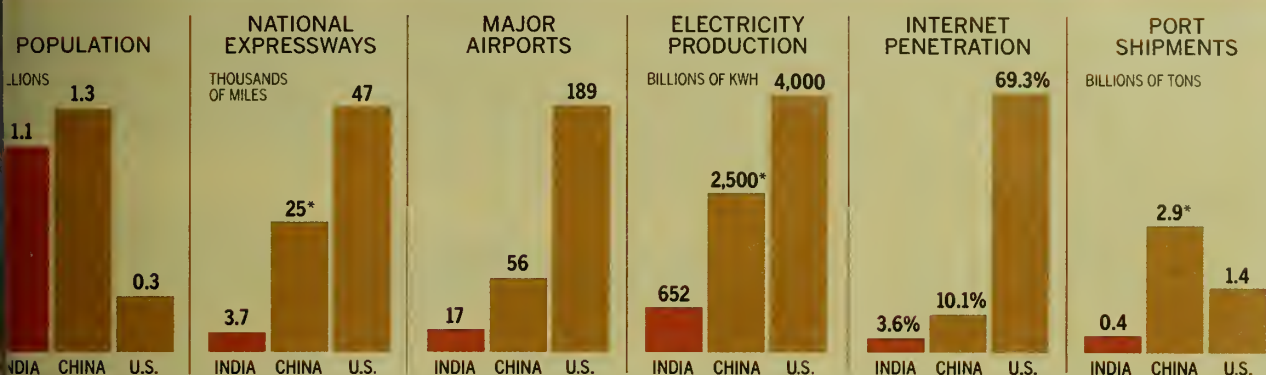
That explains why so many multinationals are flocking to India. Take hotel construction. In a country with only 25,000 tourist-

hotel rooms (compared with more than 140,000 in Las Vegas alone), companies including Hilton, Wyndham, and Ramada have plans for 75,000 rooms on their drawing boards. Or consider telecom. Because of deregulation and ferocious demand, India boasts the fastest growth in cell-phone service anywhere, with companies adding some 6 million new customers

addendum

ad nauseam

How The Global Giants Stack Up



DATA FOR '05, ALL OTHER FIGURES '06

SOURCE: CIA World Factbook, 2006; International Monetary Fund; U.S. Energy Information Administration; Portland Cement Assn.; Indian Cement Manufacturers Assn.; Morgan Stanley; India Ministry of Power; National Highway Authority of India; U.S. Waterborne Databank; Internet World Stats; National Development and Reform Commission (China); National Council for Applied Economic Research (India); U.S. Transportation Dept.; Indian Ports Assn.; China Statistical Yearbook, 2006 U.S. Census Bureau

th. No wonder Britain's Vodafone Group PLC just ponied \$11 billion for a controlling interest in Hutchison Essar, India's No. 4 mobile carrier. U.S. private equity outfits also want in the action. On Feb. 15, Blackstone Group and Citigroup announced they are teaming up with the Indian government to set up the Infrastructure Development Finance Corp. to set up a \$1 billion fund for infrastructure investments in India.

But while the laws of supply and demand would argue that India's infrastructure gap can be filled, that logic ignores the massive effect of the country's politics. To gain the favor of voters, Indian politicians have long subsidized electricity and fuel for farmers, a policy that has discouraged private investment in those areas. That's what wrecked the now-infamous Dabhol Power plant. In the late 1990s, Enron, GE, and Bechtel spent a total of \$2.8 billion building a huge complex near Mumbai capable of producing more than 2,000 megawatts of electricity. But a government power authority set prices so low that it was uneconomical for Dabhol to operate, and the whole deal fell apart. (The plant, taken over by an Indian government, now runs only fitfully.) A 2001 law was supposed to create a framework to support private investment in power generation. But according to American construction company executives, it's not working well. "Everybody knows what has to be done, but they have great difficulty doing it," says one of the Americans. "If the party in opposition offers subsidi-

dized power, the party in power has to give subsidized power to get reelected."

Politicians who refuse to play the game pay a steep price. N. Chandrababu Naidu, the former chief minister of the state of Andhra Pradesh, transformed the state capital of Hyderabad from a backwater into a high-tech destination by building new roads, widening others, and aggressively carving out land for factories and office parks. Google, IBM, Microsoft, and Motorola have all built R&D facilities there.

His reward? Voters tossed him out of office two years ago. During his decade in power, Naidu didn't do enough for rural areas, and his challenger promised to channel state funds

into irrigation projects and electricity subsidies. "Naidu thought economics were more important than politics. He was wrong," says V.S. Rao, director of the Birla Institute of Technology & Science in Hyderabad. Naidu, 56, is plotting a comeback in elections two years hence. This time, he's preaching a new gospel. "You can't just target growth," says a chastened Naidu. "You

India's government has a history of subsidization, stifling private investment

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have to create policies that make the wealth trickle down to the common man."

But even when politicians say they're beefing up infrastructure, it rarely helps the poorest Indians. Agriculture is stagnant in part because of a lack of the most rudimentary of roads to get to and from fields. N. Tarupthurai, for instance, scratches out a living from a five-acre plot in Jinnuru, a village in northeastern Andhra Pradesh. But his fields are more than a

mile from the nearest paved road, so each day the 40-year-old Tarupthurai must carry his tools, seeds, fertilizer, and crop down a dirt path on his back or on his bicycle. "I have asked for a road, and the government says it's under consideration," says the mustachioed, curly-haired farmer. Then he shrugs.

One reason little practical help makes it from the state power to India's impoverished villages is that so much money gets siphoned off along the way. With corrupt officials sk

CHANGE AGENTS

A Long and Winding Road



To understand why it's so hard to get things built in India, consider Ashok Kheny's quixotic quest. For 12 years he has sought to create a vision of modern India on the rolling, palm-dotted plains south of Bangalore. Along the way he has become entangled in India's unique blend of politics, bureaucracy, and corruption.

Kheny started off with high hopes. A native of Bangalore, he left home after college to get his master's degree in engineering at Worcester Polytechnic Institute in Massachusetts, then stayed on in America to work as a transportation contractor. In 1995 he returned to Bangalore with a bold proposal: to build a limited-access toll highway between Bangalore and neighboring Mysore, a ring road around half of Bangalore, and a handful of new townships nearby. The Karnataka state government approved the plan, so Kheny moved back—never suspecting that dynamiting the rocky terrain would turn out to be a snap compared with breaking through India's intransigent bureaucracy.

Officially, Kheny and his Nandi Infrastructure Corridor Enterprise Ltd. have been held up by land disputes and government reviews and approvals. But he claims the real problem is that he refuses to go along with the traditional way of getting things done in Karnataka. He won't pay bribes, and he won't buy off landowners or redraw his maps to accommodate them. Landowners and state agencies have filed more than 300 lawsuits against the project, and so far all have gone in Kheny's

favor, including an appeal to the country's Supreme Court. But the battle isn't over. "I get letters and phone calls threatening to kill me and my family," he says—one reason his wife and children have remained behind in the U.S.

Still, he loves nothing better than touring his construction sites in his silver Toyota Camry. In his dark blue pinstripe suit, the 56-year-old Kheny looks out of place among the huge yellow bulldozers and battalions of sweaty laborers. A drive on the 25-mile ring road is an arduous journey. Every few miles the pavement comes to an abrupt end, and the car must veer off onto rutted dirt tracks for several hundred yards until the highway picks up again. Kheny says he simply stops building when he gets to a spot where bureaucratic hassles have delayed the project. His approach is to let motorists use the paved sections as they are completed. "I tell people what's holding it up and they put pressure on the government," he says. The strategy is working: In the past three months, 7 of 10 bottlenecks have been eliminated. "Once this project succeeds, it will open up the whole country," he predicts. "It shows that if you follow the rules, you may be delayed, but you can't be stopped."

POTHOLES

For Kheny, the engineering was a snap compared with the bureaucracy

At last, the political winds in Karnataka seem to be blowing in Kheny's direction. Some ministers in a new coalition government that took office last year have lined up behind him. "We want to encourage him," says Katta Subramanya Naidu, minister for major and medium industries in Karnataka. The state's chief minister didn't respond to repeated requests for comment on Kheny's allegations of corruption. Naidu, too, declined to address them, but he acknowledged that the problem is widespread in India. "Corruption should be eradicated," he says.

The area's poor villagers once regarded Kheny as a fast-talking schemer, but they have cast aside those suspicions. Along the highway, farmers in tattered shirts and loincloths invite him to a temple they're building to Nandi, the Hindu god of transportation and the namesake of Kheny's company. The new road "is beautiful," a villager named Govind says in halting English. "When we look at it we feel like we live in a foreign country."

—By Steve Hamm

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ming at every step, many public works projects either go over budget or are never completed. "You figure that 25% of the cost goes to corruption," says Verghese Jacob, head of the Byrraju Foundation, which promotes rural development. "And then they do such a bad job that the road falls apart in one year and has to be patched over again," Jacob says as he jostles along in a car on a potholed byway outside Hyderabad.

None of the solutions to India's infrastructure challenges are simple, but business leaders, some enlightened government officials, and even ordinary citizens are chipping in to make things better. The most potent weapon India's reformers have against corruption is transparency. Last October a new right-to-information law went into effect requiring both central and state governments to divulge information about contracts, hiring, and expenditures to any citizen who requests it. The country is also putting to work its vaunted technology prowess to police the government. Officials in 200 districts are using software from Tata Consultancy Services Ltd. to help monitor a government program that offers every rural household a guarantee of 100 days of work per year. Most of this labor goes into public works. To minimize "leakage," the TCS software tracks every expenditure—and makes all of the information available real-time on a Web site accessible to anyone.

Sometimes frustrated Indians take matters into their own hands. Tired of spending four-plus hours a day in traffic, Aruna Newton last fall helped organize something of a women's crusade to speed up infrastructure improvements. Nearly 15,000 volunteers now monitor key road projects and meet with state officials to press for action. They even enlisted the state chief minister's mother, who helped get his attention. "It's about the collective power of the people," says Newton, a 40-year-old vice-president for Infosys. "I just wish building a road was as easy as writing a software program."

Increasingly, companies trying to expand in India have the government as a willing partner rather than a roadblock. The state of Andhra Pradesh rolled out the red carpet last year for MAS Holdings Ltd. of Sri Lanka, South Asia's largest garment manufacturer. It promised subsidized electricity, new access roads, and even a deepwater port if the company would place a huge industrial park on the southern coast. Now MAS Holdings plans to build a cluster of factories that will eventually employ 30,000 production workers. And it chose India over China. "The government support was absolutely vital," says John Chiramel, India director for MAS Holdings. "If we can



PRECIOUS DROPS

Catching leaking water from the hose of a government truck in a New Delhi slum

work together, there's stopping growth in the country."

A key to getting massive projects off the drawing boards is forming public-private partnerships where the government and companies share costs, risks, and rewards. In 2005, India passed a groundbreaking law permitting officials to tap such partnerships for infrastructure initiatives. Developers ante most of the money, collect tolls or other user fees, and eventually hand the facilities back to government.

The first project to take advantage of the new law is the \$430 million in-

national airport scheduled to open next year in Bangalore. The facility is designed to handle 11.5 million passengers a year—nearly double the capacity of the overburdened existing airport. It will be owned by a private company, which will turn it over to the Karnataka state government after 60 years. Global engineering and equipment giant Siemens is helping build the facility, and Switzerland's Unique Ltd. will manage it. These companies are also equity investors. The state has contributed just 18% of the cost. Without such an arrangement, Karnataka wouldn't be getting a new airport.

A lot of India's hopes rest on the airport deal's success. It proves the viability of public-private partnerships, more such ventures could come pouring in. A visit to the site instills confidence. Project manager Sivaramakrishnan S. Iyer is a veteran of mammoth infrastructure ventures through South Asia and the Mideast. Wearing a scuffed hardhat and a two-day growth of white stubble on his face, he surveys the site from a 2.5-mile-long bed of crushed granite that will become a runway. Work goes on seven days a week, 18 hours a day. "We are intent on wrapping up on schedule in April, 2008. 'We'll do it, the will to do it, and it will be done,'" he says.

Will the airport be on time? That's not within Iyer's control. Two government authorities are responsible for building the road that leads to the port, and they're locked in a dispute over how to proceed. Work hasn't started.

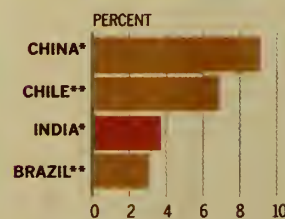
And so it goes in India. Unless the nation sheds off its legacy of bureaucracy, politics, and corruption, its ability to build adequate infrastructure will remain in doubt. So will its economic destiny. ■

—With Na-

Lakshman in Mu-

Falling Behind

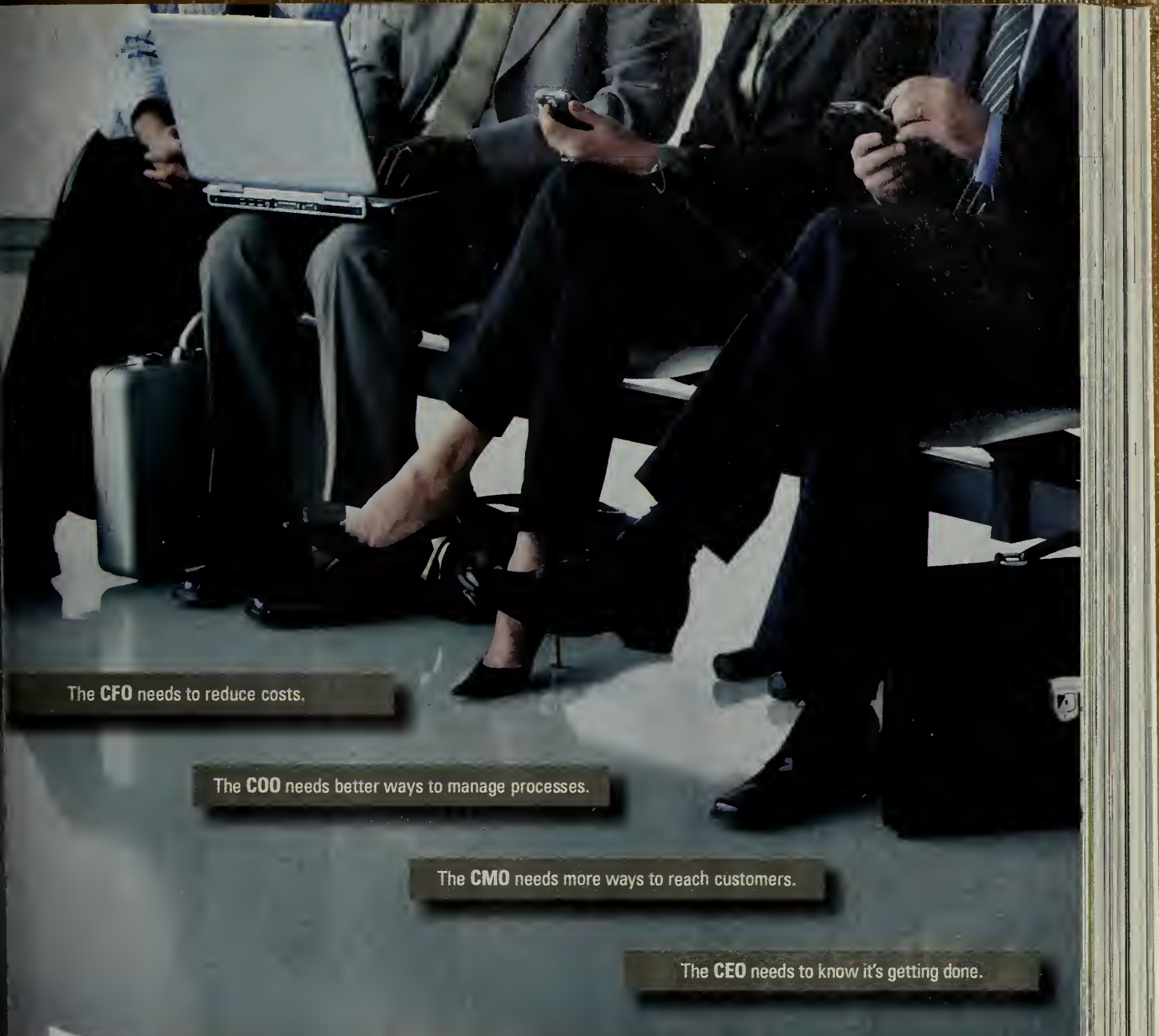
Spending on infrastructure as a share of GDP



*2005

**2006 ESTIMATE

Data: Morgan Stanley, CG/LA Infrastructure



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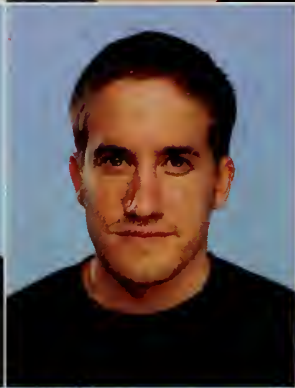
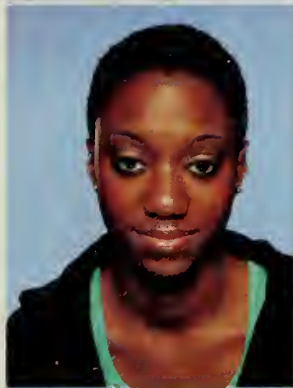
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THE BEST UNDERGRAD B-SCHOOLS





SpecialReport

Recruiting of graduates is up, salary offers are higher, and there are major changes in our Top 50

BY JANE PORTER

PHOTOGRAPHS BY CHRIS CASABURI

Undergraduate business-school students from Emory, Virginia, Wharton, and Berkeley



SOME LIKE IT COLD: Cornell location is great for skiers



SINCE OUR INAUGURAL RANKING OF undergraduate business programs last year, a lot has changed. There are nine new schools that cracked the Top 50, and salaries for grads are up across the board. ¶ Some things have stayed the same. Wharton School is once again No. 1, solidifying its hold on the title of best undergraduate B-school in America. Outstanding faculty and high-caliber students make Wharton a premier program. But Wharton isn't standing still. In 2006-07 it introduced more opportunities to study abroad, more student involvement in faculty research, and a cohort system for undergrads that allows incoming students to take classes as a group, much the way MBAs do. ¶ The University of Virginia, meanwhile, made a repeat appearance at No. 2, underscoring how different programs can excel on their own terms. A tiny two-year program at a public university, with in-state annual tuition of just \$7,845, Virginia's McIntire School of Commerce could not be more different from Wharton, an elite four-year

private-school program with enrollments and tuition about four times as high.

Yet Virginia rates higher on student satisfaction, sends a larger percentage on to top MBA programs, and is roughly on par with Wharton on key measures of academic quality. A dedicated faculty with a teaching style that demands active participation and teamwork, plus innovations such as a new multidisciplinary leadership program, don't hurt either.

We've profiled four business programs that stood out from the pack. You'll learn how the University of California at Berkeley leaped to No. 3; why the newly ranked University of Michigan is pushing out its two-year program; and how Cornell University provides opportunities for academic exploration at every turn. Naturally, you'll get a peek behind the curtain at the University's surprising jump to No. 1.

Berkeley (No. 3)

DON'T BE FOOLED BY STUDENTS lounging outdoors in the Courtyard at University of California at Berkeley's gloriously scenic campus. At the Haas School of Business,



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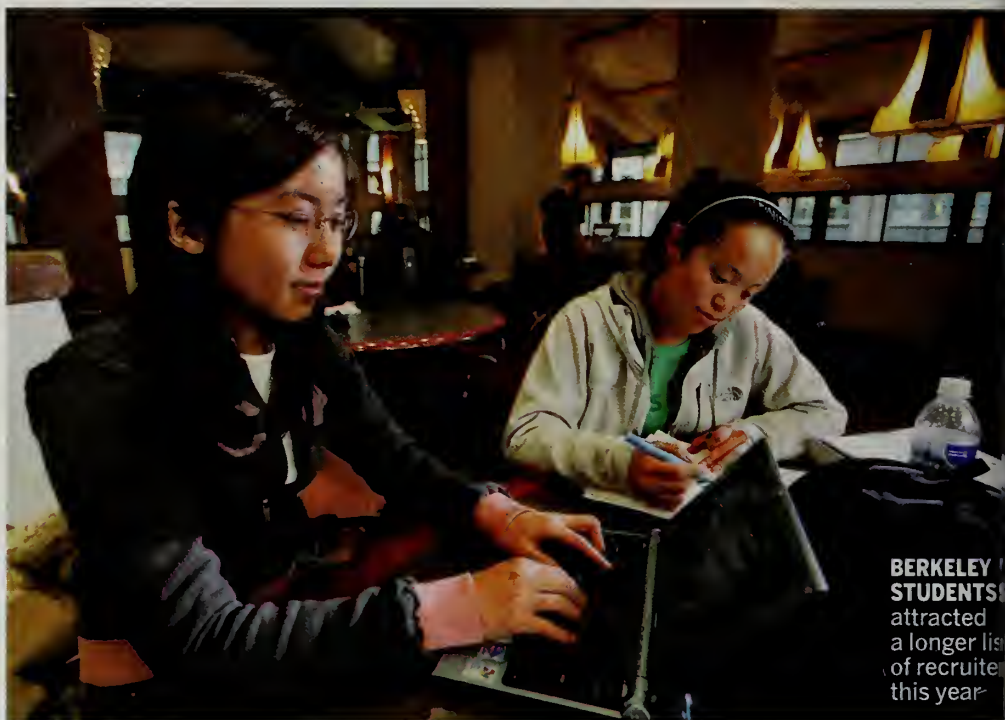
the two-year undergraduate experience is packaged much like an MBA program, complete with advanced courses and a summer cohort system that allows students to progress as a group. But recruiter satisfaction, not the program's MBA-like structure, explains why Haas rocketed up nine spots to No. 3. In 2006 recruiters ranked Berkeley 41st. This year: No. 1.

What changed their minds? Haas cranked up its recruiting efforts, staffing Berkeley's undergraduate career center with an accounts manager who reaches out to potential employers and helps place students. This fall alone, 584 companies attended career fairs at Berkeley, up from 501 last fall, including a new early-bird event in November that helped employers get a head start on intern recruiting. The fair was one of a dozen held on campus throughout the year, where the likes of Intuit, Cisco Systems, and Google sought out students more vigorously alongside such newcomers as Bloomberg.

Berkeley also lavishes white-glove treatment on recruiters, who get fresh fruit and other perks, including student guides. "When our employers step out of their cars, they are taken by the hand by students," says Tom Devlin, director of the center. To confer VIP status on such leading recruiters as McKinsey, Microsoft, and Goldman Sachs, the school put them in a group of their own called the Berkeley Circle. Members get prominent placement on the career center Web site and are encouraged to provide advice on what their companies are looking for in undergrad business majors.

Of course, companies wouldn't be depending on Berkeley if they weren't happy with the product. JPMorgan Chase & Co. recruiter Sasha Price says Berkeley students have a rare combination of business knowhow and communication skills that belies their youth. "We have had some interviewers say to us: 'My God, these Haas students know more than some of the MBAs we've just hired,'" Price says.

Although students at times feel short-changed when MBAs get preferential



BERKELEY STUDENTS attracted a longer list of recruiters this year.

treatment in everything from faculty to facilities, as they do at many other schools, there are no complaints from undergrads when it comes to the job search. Stephen Wan, a senior who will be working in Apple Inc.'s finance department this fall, says he has yet to see an unhappy employer on the Berkeley campus. It's not just the weather.

Michigan (No. 5)

WITH MORE UNDERGRADUATE business programs moving to a four-year format, No. 5-ranked Stephen M. Ross School of Business at the University of Michigan faced a conundrum. A top-ranked two-year program, it nevertheless was losing high-caliber applicants to four-year programs. The solution: split the difference at three years, and allow high school students to apply directly to the program so that they have a guaranteed spot once they're sophomores. Freshmen are also allowed to apply.

Interest in the program is already strong, and competition for spots keen. For this fall, 900 high schoolers tossed their hats in the ring. Only 65 got in, and their average high school GPA was a staggering 3.9. Those who make the grade find a college experience that is remarkably similar to an MBA program, with small classes and an emphasis on both teamwork and competition. "We're all a bunch of overachievers," says sophomore Michelle Berta.

And what about that extra year gives students the chance to take courses outside their majors, study abroad, explore various business specialties before settling on one. By allowing them to take business courses earlier, it also boosts the number of competitive internship candidates and increases the chances to intern at more than one company. More than 90% of Ross students surveyed by *BusinessWeek* reported having internships already; the average for the Top 50 schools was 74%.

Some things haven't changed. e-mail responses from diligent professors still come at 2 a.m., and competition for the top of the grading curve is stiff. White-glove treatment from B-school's own career service office is given. And although Michigan's undergraduate number about 25,000, students feel part of a tight-knit community while still getting that Berkeley experience. Says senior Jason Tan: "You have the best of both worlds."

Cornell (No. 10)

MANY B-SCHOOLS PRODUCE well-rounded grads—encouraging students to forage beyond their majors. Cornell, set in the bucolic splendor of 4,000 wooded acres in Ithaca, N.Y., takes academic exploration a big leap further. In addition to the variety they encounter outside the business program, students get a second dose inside, where they're required

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strangely enough, to take a full year of biology—thanks to the program's affiliation with Cornell's agriculture school—as well as five electives ranging from consumer behavior to emerging markets. They're also encouraged to look beyond the program for business-related courses, studying human relations in the School of Industrial & Labor Relations, or leadership in the Johnson Graduate School of Management, home of Cornell's MBA.

That's one reason Cornell, graduating a little over 200 business students annually, jumped four spots this year. "If you are a quant person who never wants to do marketing, this isn't the school for you," says Cindy van Es, a statistics professor.

At schools with both an undergrad and MBA program, the younger students sometimes get the short end of the resources stick. Not at Cornell, where the two programs have separate faculties and facilities.

There is one drawback, though. While upper-level courses may have as few as a dozen students, packed lecture halls of as many as 600 are common for introductory courses, which are shared with many nonbusiness students. Still, Program Director Ed W. McLaughlin says professors are recruited with the understanding that teaching undergraduates is a top priority. Chrissie Eckhart, a senior starting at HSBC in the fall, says one finance professor in a lecture class with 300 students knew everyone by name: "Professors really care about students."

Attracted by top-quality candidates, recruiters are more than willing to make the trek to Ithaca. The top 10 recruiters for business majors include eight big New York investment banks, among them Lehman Brothers, Morgan Stanley, and Merrill Lynch.

But for Cornell students with a hankering for power suits and city living, the upstate location takes some getting used to. Senior Jerald Chau, a Hawaii native and soon-to-be business analyst at Fannie Mae, calls Cornell's location "the boondocks," but says he has adapted. "Instead of surfing," he says, "I snowboard."

Villanova (No. 12)

IN THE SUNLIT ATRIUM OF Bartley Hall, home to Villanova's business school, students are bound to bump into at least one professor who knows their name. Downstairs in the "Exchange," servers decked out in dollar-bill ties dish out sandwiches with names like

dean meeting individually with faculty to sort out their needs. One of his big moves was to lose the dowdy "College of Commerce & Finance" name and in its place came the sleeker-sounding Villanova School of Business. "I'm concerned about Villanova's long-term brand," Danko says.

Among Danko's ideas for keeping Villanova on the cutting edge are plans for a new innovation center, which will be largely funded by alumni. He also commissioned a new undergraduate center in Bartley Hall, where B-school students will be able to get help with everything from a dorm in the family to advice on where to get the best haircut. The new facility opened in September.

The changes go well beyond the cosmetic. A revised curriculum this year will include more advanced calculus to meet the growing needs of high-caliber students, and, next year, freshmen will begin taking new introductory courses including business communication.

Faculty are learning to use financial technology tools in the classroom and have been visiting companies as Goldman Sachs, Lehman Brothers, and Johnson & Johnson to get the brains of executives generally.

And under Danko's leadership, previously overlooked fields such as marketing are finally getting their share of attention. Says Michael Radice, a senior marketing major: "They are bringing in people who are hiring all across the board."

Prospective students are taking notice of the improvements. Last year applications were up 35%, with a similar increase likely for this year. "The basketball team is hot," says Danko. "Well, so is our business school." ■

—With Louis L...



"the Naz Stack," while a stock ticker runs overhead. There, undergrads work on group projects, check e-mail on school-provided laptops, or plot investment strategies for use around the corner on the Applied Finance Lab's mock trading floor.

It's this personal attention, up-to-date technology, and emphasis on real-world learning that earned Villanova the No. 12 spot this year. That the school managed to leap seven spots in one year is a testament to a major improvement in student satisfaction. "People are happy," says Dennis Connell, a senior accounting major. "You can't escape it."

When James M. Danko arrived as dean in 2005, he wanted the business school to join the ranks of nationally recognized programs. He spent his first 100 days as

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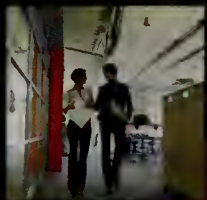
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DOES YOUR B-SCHOOL MAKE THE GRADE?

Here are four things
to consider when
applying to an
undergrad business
program

BY LOUIS LAVELLE

WHEN CONTEMPLATING A college business program, students and parents alike may find the choices paralyzing. The good news is that bad choices are getting hard to make. Starting salaries for undergraduate business majors are growing faster than those for any other discipline, and the typical new business grad now earns \$45,243, up 6.9% from a year ago, according to the National Association of Colleges & Employers. Decent salaries are all well and good—if you happen to land a job at graduation. But not everyone does. At No. 1-ranked University of Pennsylvania's Wharton School, more than 90% of business students get hired before they

PLAYBOOK BEST PRACTICE IDEAS

graduate. At No. 77, Florida State University, only 38% have jobs by the time they receive their diplomas.

Meanwhile, programs are getting more selective, and students who might have made the grade a few years ago no longer do. Schools also are ratcheting up quality or starting specialized programs. For many students these programs represent the best choice, even if it means relocating across the country. It's worth asking which schools are best at finding students decent internships. Finally, it's not a bad idea to investigate grading practices, since grading curves might hinder the job search.

So, read on. And choose well.

Competition is fierce

1 ONCE CONSIDERED A HAVEN for less academically gifted students, undergraduate business programs are raising their standards. With more students beating a path to their doors, many B-schools are boosting their admission criteria and getting fussier.

At schools with four-year programs, SAT and ACT requirements have gone up. The average SAT score for freshmen admitted to the Indiana University business school, where applications nearly doubled last year, is now 1340—up from 1310 in 2005-2006 and a full 343 points higher than the national average for test takers who intend to major in business. At universities with two-year business programs, especially those like the University of North Carolina where more than 2,000 declared business majors are waiting to join a program designed for 1,300, GPA requirements, pre-business courses are rising, too.

For students, the higher bar requires a strategic rethink. Many already take standardized tests multiple times to maximize scores. Those with lower scores who are applying directly to four-year business programs are beefing up applications in other ways, including taking part in extracurricular activities, working as fund-raisers. Savvy applicants assess their likelihood of being accepted at their choice schools and give more thought to less selective “safety” schools.

Those applying to a four-year school with a two-year business program are advised to contemplate what they will do if they can't find places as juniors. Credits accumulated in the first two years might be transferred to another school.

may put, declare another major, and a minor in business instead?

a national game

UNDERGRADUATE BUSINESS EDUCATION used to be a local or regional affair. That's changing. Too many students attend programs far from home.

Out-of-state schools may provide a wider array of programs than those available in an applicant's home state. They include leadership, entrepreneurship and global business. A number of schools have launched specialized programs that place students in high-growth industries that are located in the school's backyard—such as sports management at the University of Oregon, home state of Nike and Adidas, among others; energy commerce at MIT; Tech University; life sciences at Wharton; and both liberal arts and computer engineering at the University of Southern California.

While academic offerings aren't enough to get the intellectual juices flowing, consider this: Out-of-state tuition at public universities can be a bargain. Attending a top private B-school like Wharton easily cost more than \$30,000 a year, excluding room and board and other expenses. A highly ranked public school like the No. 2 University of Virginia costs \$25,945; No. 13 University of Texas at Austin is \$22,580; and No. 15 University of North Carolina, \$18,010.

Many of the public schools have programs that are roughly on par with

private institutions—in terms of class size, faculty-student ratios, and other measures. Public schools can also be easier to get into. The average SAT score at Wharton is 1430—compared with 1366 for Virginia, 1335 at UNC, and 1275 for Texas-Austin.

Sometimes out-of-state schools, public or private, are better at finding grads decent jobs. If a school has established recruiting relationships with specific industries, it may be worth a look—no matter

where you recruit—the message is clear: change career goals, or start packing.

Internships matter

3 INTERNSHIPS ARE A VALUABLE learning experience. Since many employers use them as extended tryouts for full-time positions, they are also an important pipeline to the most coveted jobs. So scoring one ought to be near the top of every undergrad's agenda. Yet not all programs provide the same access to internships. At No. 5 University of Michigan, 92% of undergrads who completed our survey had internships, compared with less than 25% at No. 81 University of Texas at Dallas. And not all internships are created equal.

Co-op programs at the University of Cincinnati, Northeastern University, and Penn State allow students to graduate with up to two years of work experience. Elsewhere, a three-month summer internship is the norm.

Why the disparity? For one thing, location matters. To a casual observer there wouldn't appear to be much to differentiate the undergraduate B-school program at Fordham University from that of the University of Denver. Both are private, four-year programs. Tuition and enrollment are almost identical. And in last year's ranking they came in at No. 48 and No. 49, respectively. But at Denver, 57 companies recruited undergrads for internships. At New York-based Fordham: 200. Emily Sheu transferred from No. 4 Emory University to No. 34 (this year) Fordham, where she had internships at Bloomberg and Merrill Lynch & Co. For



where it is. Are you an aspiring accountant? All of the Big Four firms recruit at Texas-Austin. Aiming for Wall Street? Recruiters for eight financial-services giants are among the 10 top recruiters at New York University. For a would-be "master of the universe" living in Oklahoma who is considering the University of Oklahoma—where no big investment banks

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Transforming
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her, it was all about location. "Atlanta," she points out, "is no Manhattan."

Students at three- and four-year programs are more likely to take in-depth business courses early, making them more competitive internship candidates. That's one reason why the University of Michigan is phasing out its two-year program in favor of a three-



year model. Also, watch out for summer school. When schools schedule classes in the summer before the junior year, having more than one internship before graduation becomes near-impossible.

Beware the grading curve

4 ARE GRADES REALLY SUCH A big deal? The answer is a resounding "yes," especially for those considering schools like Michigan, Babson College, Oregon, or Pennsylvania, where grading curves are a fact of business school life. Curves designed to counter grade inflation by limiting the number of As in any given class can make it difficult for even high performers to land interviews with some recruiters.

USC's Marshall School of Business grades students on a curve, with professors expected to hold the average GPA to 3.0 in core courses and 3.3 in electives. Most students will get a 3.0, or a B, in each of their 10 core business courses. A handful will earn a slightly higher grade, and the same number will earn a lower grade.

For recruiters trolling B-school campuses, a GPA of under 3.5 will in many cases consign a résumé to the bottom of the stack. At Marshall, most large employers take the grade structure into consideration, so students are rarely passed over for interviews. But for smaller companies not familiar with the school, students are at a disadvantage. David Freeman, a

THE TOP 50 UNDERGRAD

RANK	2007/2006	School Name	PROGRAM INFORMATION			Student Survey Rank	Recruiter Survey Rank
			Program Type	Annual Cost	Full-Time Enrollment		
1	1	Pennsylvania (Wharton) Philadelphia	Priv., 4-yr	\$34,156	2,384	4	4
2	2	Virginia (McIntire) Charlottesville	Pub., 2-yr	\$7,845	650	1	33
3	12	UC-Berkeley (Haas) Berkeley, Calif.	Pub., 2-yr.	\$7,704	700	11	1
4	5	Emory (Goizueta) Atlanta	Priv., 2-yr	\$32,100	579	2	14
5	6	Michigan (Ross) Ann Arbor	Pub., 3 yr	\$11,713	731	8	9
6	4	MIT (Sloan) Cambridge, Mass.	Priv., 3 yr	\$33,400	264	5	27
7	3	Notre Dame (Mendoza) South Bend, Ind.	Priv., 3 yr	\$32,900	1,529	3	21
8	8	Brigham Young (Marriott) Provo, Utah	Priv., 2-yr	\$3,620	1,640	6	2
9	7	NYU (Stern) New York	Priv., 4-yr	\$34,616	2,271	16	23
10	14	Cornell Ithaca, N.Y.	Priv., 4-yr	\$18,241	682	10	39
11	13	Georgetown (McDonough) Washington	Priv., 4-yr	\$33,552	1,274	15	45
12	19	Villanova Villanova, Pa.	Priv., 4-yr	\$33,000	1,907	13	17
13	9	Texas (McCombs) Austin	Pub., 4-yr	\$8,688	4,140	12	5
14	23	Boston College (Carroll) Boston	Priv., 4-yr	\$33,000	1,997	22	18
15	11	North Carolina (Kenan-Flagler) Chapel Hill	Pub., 2-yr.	\$5,034	670	14	57
16	15	Washington U. (Olin) St. Louis	Priv., 4-yr	\$32,800	745	19	37
17	24	Wake Forest (Calloway) Winston-Salem, N.C.	Priv., 2-yr	\$32,040	398	39	29
18	10	Indiana (Kelley) Bloomington	Pub., 4-yr	\$7,460	3,842	9	11
19	21	USC (Marshall) Los Angeles	Priv., 4-yr	\$33,314	3,710	18	15
20	18	Lehigh Bethlehem, Pa.	Priv., 4-yr	\$31,180	1,246	21	31
21	16	Carnegie Mellon (Tepper) Pittsburgh	Priv., 4-yr	\$34,180	475	50	34
22	22	Illinois Urbana-Champaign	Pub., 4-yr	\$11,170	2,967	44	3
23	25	Richmond (Robins) Richmond, Va.	Priv., 2-yr	\$36,550	566	31	87
24	20	SMU (Cox) Dallas	Priv., 4-yr	\$27,400	941	7	77
25	NR	U. of Washington Seattle	Pub., 2-yr	\$5,985	1,524	57	13

BUSINESS PROGRAMS

		QUALITY MEASURES					
Index	Rank	Faculty-Student Ratio	Average SAT/ACT Scores	Teaching Quality Grade	Facilities & Services Grade	Job Placement Grade	Student comments
100.00		10.5	1430/NA	A+	A+	A+	Last year's top program is still in a class by itself: outstanding faculty, high-caliber students, and an unparalleled alumni network.
92.74		10.8	1366/NA	A+	A+	A+	McIntire's third-year Integrated Core Experience, strong faculty, and Type-A students make UVA a destination for top national recruiters.
91.86		26.9	1355/NA	A	A+	A	Top-flight faculty and recruiting efforts combined with a responsive administration put Berkeley on top.
91.16		9.2	1340/NA	A+	A+	A+	Experienced professors, challenging courses, and community events wow many. The popular Greek scene might not be for everybody.
87.98		5.7	1317/29.0	A+	A+	A+	Difficult business core focused on action-based learning has students feeling prepared to take on the real world.
86.06		2.8	1478/31.0	A+	A+	A+	Undergrads like the option of taking elective classes with the Sloan MBAs. While the homework load is heavy, students leave feeling prepared.
84.74		16.8	1379/31.3	A+	A+	A+	Broad pre-business requirements help students make the right decision in choosing a major. Career services office is strong.
80.05		13.0	1222/27.0	A+	A+	A+	Ethics are emphasized in the BYU classroom, and students are impressed with high-caliber recruiters.
77.13		11.5	1441/31.0	A	A	A+	Finance students get the majority of attention, at the expense of those in marketing. Grads say "Stern curve" makes getting an A difficult.
76.81		17.5	1333/28.4	A+	A+	A	Class sizes of 300 or more don't stop professors from really getting to know their students. Accounting offers few upper-level courses.
76.67		25.0	1352/29.0	A+	B	A+	Recruiters from Wall Street and well-rounded faculty make for a strong finance program. However, students in other departments feel neglected.
74.46		19.3	1282/29.0	A+	A	A+	Dedicated faculty, small classes, and outstanding accounting program make 'Nova a standout, but marketing majors have trouble finding jobs.
74.37		44.5	1310/29.0	A+	A+	A+	Small class sizes and individual attention leave students satisfied. Some would like to see more recruiters from outside Texas.
71.86		21.0	1328/29.0	A+	A	A+	Alumni and professors love helping students find jobs, making BC's campus networking an invaluable resource.
71.84		14.9	1335/NA	A+	A+	A+	The intimate program creates a "private school education at a public school price," where undergrads and MBAs share courses.
71.06		11.5	1443/31.0	A+	A+	B	Dedicated faculty and London internship program get raves, but career services can do a better job of getting top companies to campus.
71.05		14.7	1322/NA	A+	A	A	Challenging coursework, small classes, and demanding professors make for an intense experience. Grade deflation leaves many disappointed.
70.87		24.8	1222/28.0	A+	A	A+	Undergrad facilities need improvement. Yet grads say job placement is top-notch and professors are passionate and willing to go the extra mile.
69.88		33.4	1379/NA	B	A+	A+	Helpful career services, far-flung alumni network, and quality teaching set Marshall apart. Grading curve irks many.
69.50		19.5	1281/NA	A+	A	A+	A strong accounting program wins student praise, although many say they could use more advanced computer training.
68.83		4.9	1410/30.0	B	C	B	Students extol quantitative training and research opportunities, but say many of their peers are lacking in soft skills like communication.
67.02		27.7	1310/29.5	B	B	A+	The career service office plays a huge role in job placement. Professors, however, tend to focus more on research than teaching.
63.74		11.5	1283/27.7	A+	A	A	Personal attention is a plus, but required professional development courses get a thumbs down, as does an unresponsive administration.
63.11		18.5	1393/31.0	A+	A+	A+	Students complain that classroom experience is based too much on theory and not enough on the real world.
62.29		18.4	1207/25.0	A	A+	B	Focus on international business, a top-notch accounting program, and dedicated faculty win raves. A badly needed facelift is on the way.

recent Marshall grad, estimates that he missed out on a dozen interviews because he didn't meet the grade requirements companies were looking for. "Without the curve, my GPA would have been high enough to qualify for these interviews," he says.

While a grading curve probably isn't a deal-breaker for students choosing among a handful of schools, it's certainly something that should be taken into consideration. It's worth asking, for example, if the policy is school-wide or if individual professors make their own rules, and whether the curve covers core courses, electives, or both.

Some students say that curves cause morale problems among students, intensifying competition and making it harder to form meaningful teams. Before enrolling in a program, prospective students should find out what, if anything, the school is doing to counter those problems. ■

—With Geoff Gloeckler and Jane Porter

METHODOLOGY

To identify the best undergraduate business programs, *BusinessWeek* used five measures, including a survey of nearly 80,000 business majors at top schools and a poll of undergraduate recruiters. To understand career outcomes better, we also looked at starting salaries for graduates and how many each school sent to top MBA programs. Finally, an academic quality score—a combination of five measures including average SAT scores and faculty-student ratios—identified schools with the smartest and best-served students.

The ranking is based on the "index number," which represents the sum of all five ranking measures. We also calculated letter grades on teaching quality, facilities and services, and job placement based on the student survey. In each category, the top 20% among all 93 ranked programs earned A+s. The next 25% got As, the next 35% got Bs, and the bottom 20% got Cs. For a complete list of schools, go to businessweek.com/bschools/undergraduate, to see Q&As, slide shows, interactive tools, and a full description of the ranking methodology.

Footnote: Annual program costs include tuition and required fees for in-state students. Figure shown for Miami University is the balance paid by Ohio residents, who receive two scholarships to attend the university. Full-time enrollment is for undergraduate business program only. Starting salaries are 2006 medians except for Santa Clara (2005 median). MBA Feeder School Rank based on respondents to 2002, 2004, and 2006 *BusinessWeek* surveys of MBA students who reported having undergraduate business degrees from ranked undergraduate programs. Academic Quality Rank based on average SAT scores for business majors, full-time faculty-student ratio in business program, average class size in core business classes, percentage of business majors with internships, and average number of hours per week business majors reported spending on class work. Average SAT/ACT scores are for entire program. Letter grades represent only a part of total student survey results; highly ranked programs may have low letter grades while lower ranked programs may have high letter grades. NA=not available. NR=not ranked.

Data: *BusinessWeek*, Cambria Consulting Inc.

Research by: Fred Jespersen, Louis Lavelle, Geoff Gloeckler, Jane Porter, Paula Lehman, Kristen Fiani, and Janie Ho.

THE TOP 50 UNDERGRAD

RANK	2007/2006	School Name	PROGRAM INFORMATION				Student Survey Rank	Recruit Survey Rank
			Program Type	Annual Cost	Full-Time Enrollment			
26	37	Northeastern Boston	Priv., 4-yr	\$29,910	3,031		30	32
27	NR	Santa Clara Santa Clara, Calif.	Priv., 4-yr	\$30,900	1,472		46	20
28	27	Wisconsin Madison	Pub., 2-yr	\$6,730	1,250		26	53
29	NR	William & Mary (Mason) Williamsburg, Va.	Pub., 2-yr	\$8,490	420		45	82
30	36	Maryland (Smith) College Park	Pub., 4-yr	\$7,906	2,777		51	22
31	31	Bentley Waltham, Mass.	Priv., 4-yr	\$29,810	3,816		24	47
32	NR	Rutgers Camden, N.J.	Pub., 2-yr	\$8,084	690		86	10
33	28	Babson Babson Park, Mass.	Priv., 4-yr	\$32,256	1,776		56	68
34	48	Fordham New York	Priv., 4-yr	\$30,000	1,848		48	42
35	17	Miami U. (Farmer) Oxford, Ohio	Pub., 4-yr	\$9,911	4,131		49	16
36	32	Penn State (Smeal) University Park	Pub., 4-yr	\$13,338	5,274		33	6
37	30	Boston U. Boston	Priv., 4-yr	\$33,330	1,788		78	50
38	38	Baylor (Hankamer) Waco, Tex.	Priv., 4-yr	\$22,889	2,950		25	61
39	33	Texas Christian (Neeley) Fort Worth	Priv., 4-yr	\$26,300	1,694		20	62
40	NR	Rensselaer Polytech (Lally) Troy, N.Y.	Priv., 4-yr	\$32,600	377		32	83
41	43	Ohio State (Fisher) Columbus	Pub., 4-yr	\$9,426	3,090		35	8
42	26	Minnesota (Carlson) Minneapolis	Pub., 4-yr	\$9,933	1,685		41	66
43	47	Florida (Warrington) Gainesville	Pub., 2-yr	\$2,968	2,395		52	7
44	NR	Georgia Tech Atlanta	Pub., 4-yr	\$3,820	1,195		54	12
45	NR	Clemson Clemson, S.C.	Pub., 4-yr	\$9,868	2,415		40	5
46	NR	San Diego San Diego, Calif.	Priv., 4-yr	\$30,480	1,200		58	30
47	NR	U. of Miami Coral Gables, Fla.	Priv., 4-yr	\$31,288	2,063		23	9
48	29	Michigan State (Broad) East Lansing	Pub., 2-yr	\$10,053	2,017		27	3
49	46	Marquette Milwaukee	Priv., 4-yr	\$25,074	1,549		29	8
50	34	Texas A&M (Mays) College Station	Pub., 4-yr	\$6,966	3,851		17	4

BUSINESS PROGRAMS

		QUALITY MEASURES					Student comments
Academic Rank	Index Number	Faculty-Student Ratio	Average SAT/ACT Scores	Teaching Quality Grade	Facilities & Services Grade	Job Placement Grade	
5	62.08	28.6	1240/26.0	B	B	A+	The five-year co-op program almost ensures that students will have a job when they graduate. Boston locale is a big selling point.
	61.93	16.2	1203/NA	A	C	A+	Small class sizes and dedicated support staff leave students satisfied with their experience at Santa Clara.
	60.90	19.5	1257/27.6	A	A+	A+	Real estate, accounting, and actuarial science programs all rate high with students, and new facilities are planned. But advising needs work.
	59.96	10.0	1290/28.0	A	A	B	Accounting and finance majors get most of the jobs. The administration is responsive—if students complain about profs, heads roll.
	58.27	20.7	1360/30.0	C	B	A	Teamwork focus satisfies students. The school's emphasis on securing internships and jobs sometimes detracts from the academic experience.
	57.45	22.2	1206/25.0	B	A+	A+	Helpful career services and real-world class exercises are a plus, though marketing students feel neglected when it comes to the job search.
	56.90	12.3	1219/NA	C	C	B	A dedicated, high-caliber student body is valuable. Grading curves make it difficult for students to earn As.
	56.88	19.7	1265/28.0	A+	C	B	The social scene may be a bust, but the opportunity for freshmen to start their own businesses is a plus.
	56.67	15.7	1178/24.9	A	A	A	With NYC at their fingertips, students say work opportunities are plentiful and useful. The facilities, however, could use a facelift.
	55.71	30.8	1206/26.5	A	A	A	The tight-knit community has students cheering. Downside: Most would like to see more recruiters on campus from outside of Ohio.
	55.54	47.9	1208/26.0	B	A+	A	Large program makes it hard for students to get face time with advisers. Co-ops give students useful work experience.
	55.15	17.2	1278/28.0	A	A	C	An emphasis on teamwork and real-world experience is a plus, yet students say grading on the whole is too tough.
	54.46	25.9	1183/25.0	A	A	A	It's not unusual for professors to give out their cell phone numbers to business students; classes rarely top 30 students.
	54.12	27.3	1165/25.0	A+	A	A	Students are smart, if sometimes unmotivated, and getting a high quality professor is hit or miss. Campus upgrades have students excited.
	53.08	9.2	1212/NA	A	B	B	Many companies recruit on campus; students wish that more were looking for management majors instead of IT.
	53.05	38.1	1203/26.0	B	A+	A	Most business courses are centered on group work. Getting into required courses is sometimes a challenge.
	53.02	30.1	NA/28.0	C	B	A+	The rigor and value of Carlson courses vary a lot across class sections and majors. Recruitment services could not be better.
	52.88	23.0	1300/29.0	B	A	B	Accounting program gets high marks, but students are put off by online classes that make connecting with professors and peers difficult.
	52.05	29.1	1261/27.0	A	A	B	Graduates praise the emphasis on technology and engineering. Large class size limits personal attention from professors.
	51.97	27.8	1206/27.0	B	A	A	Students say Clemson professors are friendly and know their stuff. There's a diverse range of business courses to sample.
	51.93	20.3	1174/29.5	B	B	B	Accounting program makes the grade, and professors win high marks for availability outside class.
	51.57	14.7	1269/28.0	A	A+	B	Pre-business courses give business students a leg up, while mentors and full-time advisers provide a personal touch.
	51.53	24.3	1151/25.0	B	A	A	Students applaud the Lear Center for help in the job search, but many would like to see higher admission standards.
	50.89	24.2	1179/26.1	A	A	A	Grading curve is unpopular; the focus on ethical and moral reasoning is a hit. Alumni mentoring program leaves students happy.
	49.45	36.3	1183/25.0	A	A+	A+	Though large, Mays has a small-school feel. Students work hard to manage heavy class load with Aggie social activities.

Market Mania In China

Stocks remain a wild gamble, but millions of unsophisticated investors are rushing in

BY FREDERIK BALFOUR
AND DEXTER ROBERTS

IT'S A FRIGID TUESDAY MORNING, and China's capitalists are just getting warmed up. The Baijiazhuang branch of the Citic Securities brokerage in eastern Beijing is packed with more than 100 investors milling around the unheated room. They sip green tea while perusing pages of the *China Securities Journal* plastered on the wall or gaze up at ticker screens overhead. Some punch orders into grimy PC terminals, while others sit under No Smoking signs puffing on cigarettes and playing Chinese chess.

Charles Schwab it's not. Most of China's "trading halls" feel more like betting parlors than prosperous brokerages. But they're front-and-center in the mainland's love affair with stocks. China today has some 81 million trading accounts, up from 61 million six years ago. In January alone, 341,000 investors—retirees, housewives, government officials, professionals, students—opened new accounts, vs. just 11,000 accounts added in January, 2006. Although less than 5% of the population owns equities, compared with more than 50% in the U.S., the trading halls are full, online chat rooms and financial Web sites are hopping, and just about everyone you meet has a hot tip. "A lot of elderly women play the market," says Ms. Li, a regular at Baijiazhuang who, like many other traders, declined to give her full name. "They should be careful because they are not strong and the high risks of the market could harm them," counsels the retired accountant. Li, 59, apparently feels she's made of sturdier stuff: She has plowed 20% of her savings into stocks.

The stampede into equities has set China's markets on fire for the past 12 months. The Shanghai A-share index

(which tracks stocks largely restricted to Chinese investors) is up 120% in the past 12 months, even after the Feb. 27 rout that saw the exchange shed nearly 9% of its \$1.1 trillion market capitalization in a single day. And although the Shanghai exchange is now trading at around 35 times next year's projected earnings (compared with 15 for the Standard & Poor's 500-stock index), Chinese continue to rush in. By some estimates, individual investors make up two-thirds of the market. That's partly because they have few other options: Local banks pay around 2.5% interest on deposits, and property prices in many cities have soared so high that real estate is beyond the means of many. These greenhorn investors "are momentum players who tend to jump on the bandwagon when the market is going up," says Jing Ulrich, Chairman of China Equities at JPMorgan Chase & Co.

QUICK BUY AND SELL

FOR MANY IN CHINA'S new shareholder class, stockpicking is more art than science. Li, for instance, can't resist a bargain: "I like stocks that cost no more than 8 renminbi [\$1]." And you can forget about the concept of buy and hold. "I generally keep a stock for about a month" or until it has seen gains of about 10%, says Ms. Wang, a 52-year-old former department store clerk. Her hair-trigger tactics have not stood her in good stead: "I see that other people have earned a lot from the stock market, but I never have," she admits.

Even those who've



SHANGHAI The A-Share index is up 120% in a year

been burned before are coming. Zhai Maohui is a regular at Baijiazhuang when he's not piloting flights to San Francisco or Los Angeles from China. An investor for more than a decade, he lost nearly all his money during a market bust in 2005. But his luck improved, with his stocks tripling in value in the past 18 months. "I put the money I am able into the stock market," says Zhai, 59, who expects it to keep rising as the 2008 Beijing Olympics nears. "There are no risks for investing in the market right now."

Not all Chinese investors are that sanguine. Many try to educate themselves, poring over analyst reports available free of charge at Web sites such as Hexun and China's stock and chat rooms. Unfortunately, what's for information online is sometimes more than a Shanghai-listed Industrial property developer with meager earnings, shot up 300% one week last October on chatter that it was about to get an asset



75

Private Equity Goes Public

Firms like KKR are buying stakes in public companies and pushing, gently, for change

BY EMILY THORNTON

CAN VORACIOUS BUYOUT firms like Kohlberg, Kravis & Roberts earn big returns from simply buying a stake in a public company? KKR thinks so.

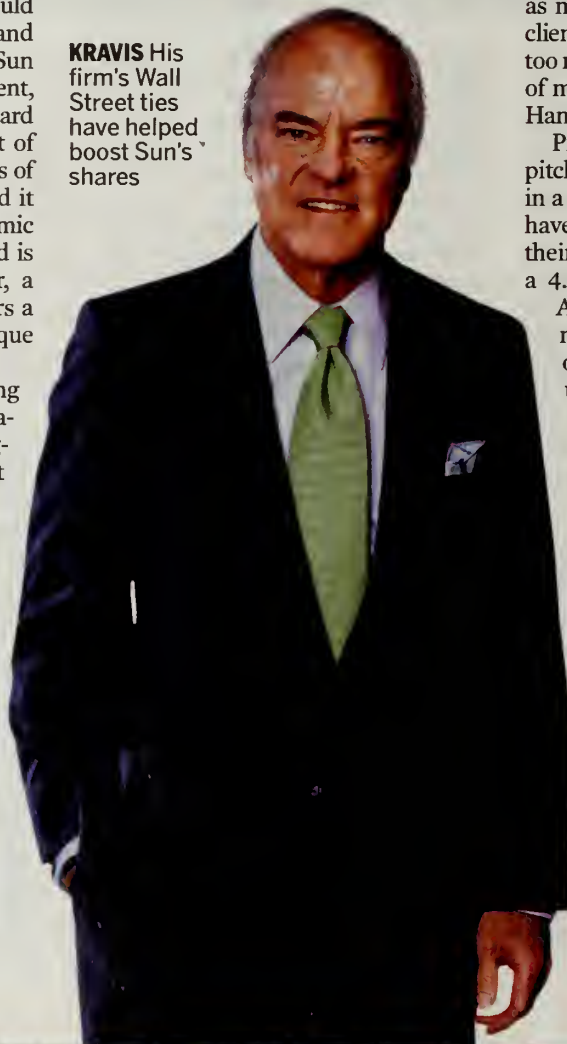
On Jan. 23, KKR, for one of its publicly traded funds, bought \$700 million of Sun Microsystems Inc.'s convertible debt. Sun was gratified by the deal, hoping it would send the message to Wall Street that the tech outfit would emerge from its struggles. Both KKR and Sun should be pleased: Shares in Sun have risen 7% since the announcement, compared with a 3% drop for the Standard & Poor's 500-stock index. It's the sort of halo effect usually reserved for the likes of legendary investor Warren Buffett, and it may signal there's a new player to mimic in the market. "I think Buffett's record is unmatched," concedes Bret Schaefer, a vice-president for Sun. But "KKR offers a range of relationships that brings unique value." KKR declined to comment.

As private equity giants with bulging war chests race to buy ever-larger companies, a growing number of players ranging from boutiques to major buyout firms are acting like hybrids of passive mutual fund managers and activist

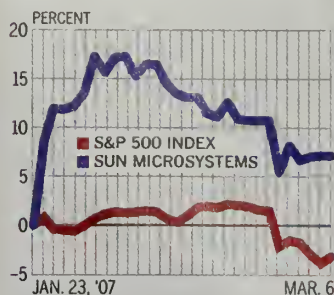
hedge funds. In the quest for extraordinary gains, private equity players like KKR are taking minority stakes in public companies, often through private placements, and working with management teams to enact change. But unlike agitating shareholders, they aren't hedging their positions or launching hostile proxy fights.

At Sun, KKR is a cheerleader, chatting up other major investors on conference calls about the hidden value in the software maker. With this new relationship,

KRAVIS His firm's Wall Street ties have helped boost Sun's shares



RISING SUN



Data: Bloomberg Financial Markets

KKR can play matchmaker, giving Sun shot at being a supplier to its 37 port companies, a group with \$97 billion revenues. Sun will likely also elect a executive to the board, and the private equity firm will serve as counselor for tech outfit's upcoming acquisition spree. "They will give us free advice that would have otherwise had to pay investment bankers for," says Schaefer.

In some ways, it's a natural brand tension for private equity. Most firms at hundreds of potential buyout targets before taking only a dozen or so private. But in separating the wheat from chaff, they miss out on more traditional stock and bond opportunities. If they've vested in public markets, they would only expand their horizons but also at paying a fat premium, as they do in a buyout deal. Extra bonus: If things don't work out as they predict, the funds can pull out of the investment more easily.

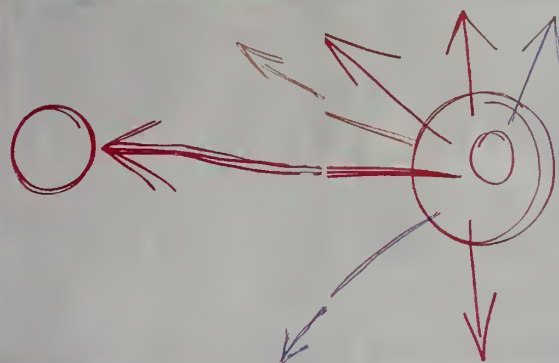
MIXED RECORD

STILL, THIS TACK sparks controversy. Some private equity investors resent paying 1% to 2% management fees and getting up 20% of profits for what they perceive as mutual-fund-like moves. "Most of our clients on the pension side say the fees are too much," asserts Mario L. Giannini, of money management and advisory Hamilton Lane.

Private equity outfits, which usually pitch the advantages of making change in a private setting over a public one, have a mixed record when they stray from their expertise. Blackstone Group bought a 4.5% stake in Deutsche Telekom in April, but so far its \$3.5 billion investment is down \$315 million. On the other side of the spectrum, private equity giant Warburg Pincus has at least \$390 million, or 118.45% of its private placement investments in public companies since 2005, according to PlacementTracker. Blackstone and Warburg declined to comment.

Some boutique firms, such as Blum Capital Partners and Sagamore Capital, think there are so many opportunities in the markets that they don't need to play in the traditional private equity space. Says N. Lind, a managing partner at Capital: "We're in the business for influence, not control."

That's the kind of relationship some companies cozy up to. Says Sun's Schaefer of KKR: "It's almost like having an extra member on my investor relations team." ■



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Weaving the Web To Your Taste

Hossein Eslambolchi's service will scour the Net for the media you want

BY PETER BURROWS

WITHIN TELECOM circles, some regard Hossein Eslambolchi as the savior of Ma Bell. In 2002, with AT&T's long-distance revenues fast disappearing, former Chief Executive Dave Dorman called the company technologist at his Silicon Valley home to ask him to become "chief transformation officer" and push through a radical rewiring.

Three years later, Eslambolchi had replaced AT&T's aging, inefficient voice and data networks with a single Internet-based one smart enough to handle everything from basic calls to sophisticated corporate software applications over one set of gear, with less cost and complexity. That was a major reason SBC Communications Inc. paid \$16 billion for AT&T in 2005.

Now, having helped design the plumbing that carries hundreds of millions of blog posts, songs, and video clips each day, Eslambolchi is about to launch one of the Web's more intriguing technology forays. His goal? Making sense of all those bits. On Mar. 13, Eslambolchi's 10-person startup, Divvio Inc., will turn on a service that automatically finds audio, video, and, eventually, text, on your favorite subjects. Then it weaves these clips together to create personalized multimedia channels that are updated each time you sign on. A channel on the New York Yankees might start with spring training highlights, followed by videotaped interviews and blog postings.



That would be quite a change for Netizens, who have grown used to clicking back and forth between bookmarked sites or wading through increasingly cluttered personal portals such as My Yahoo! or MySpace.com. Backed by \$3 million-plus raised from angel investors including former executives of Yahoo and eBay, Eslambolchi has been working 16 hours a day since leaving AT&T in late 2005, after turning down an offer to stay with the combined company. "We're going to give you the best of the Web, but only what's relevant to you," says the Iranian-born Eslambolchi, 49.

It's an ambitious goal, backed by technology of mind-numbing complex-

ity. And that might be Divvio's big hurdle. Even the most focused struggles to solve a single major problem; Eslambolchi is taking on several at once, with a technology he calls ALIP, for "adaptive learning intelligence process."

First, Divvio's software trawls the Web indexing content not just by subject title, but by bandwidth, duration, and a dozen other attributes. Then a "personalization engine" matches each consumer's desires to this data base—senior based on past requests, that the user is interested in Madonna the singer, not the mother of Christ. Finally, Eslambolchi

THE PLUMBER
Eslambolchi redesigned the AT&T network

says, the Divvio servers will stitch the elements together in seconds, regardless of what media formats they were coded in.

Sounds impressive.

But the site has to work right out of the box if it's going to win fickle Web users. If not, "it could get old very quickly," says Mike McGuire, a Gartner research vice-president. Divvio isn't the only company trying to help Web users corral content. For instance, Joost, from the founder of music file-sharing site Kazaa and Skype Internet-phone service, is hoping to be a one-stop shop for viewing TV shows over the Net.

LEARNING CURVE

ESLAMBOLCHI WILL FACE a major marketing challenge to break through Web 2.0 clutter. And early users will need some patience. That's because Divvio crawls only 750,000 sites at first, a fraction of the entire Web, and because

ALIP needs time to learn. Divvio figures it will only hit the mark 10% of the time with its first customers; he says that will rise to 60% by yearend.

Divvio hopes to make money by sharing ad dollars with content providers, or earning fees with phone carriers once the service is able to run on mobile devices. After all, if Divvio works, it should generate reams of media transmissions. To Eslambolchi, that would help justify those newfangled networks he had a hand in creating. As he points out: "The world's carriers have invested \$10 billion in [high-speed mobile] networks, but what are they doing with them? Email and instant messaging." ■



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HONDA
The Power of Dreams

COMMENTARY

BY ARIK HESSELD AHL

What to Do with Apple's Cash

Its \$12 billion and tech expertise could nurture promising startups

WHAT WOULD YOU DO with \$12 billion? That's how much cash Apple Inc. had on its balance sheet when it reported its latest quarterly earnings on Jan. 17. Driven by the wild success of the iPod line and the rejuvenated Macintosh, Steve Jobs and crew are rolling in it. And that cash hoard is growing by about \$1 billion

and change per quarter. Apple might not be the richest tech outfit around: Microsoft Corp., after all, has about \$29 billion in cash. But with 61% of its assets held in cash, Apple dwarfs Microsoft (44%) on a relative basis.

Any other company with such a fat savings account—and zero debt—might be castigated by shareholders or even become a target of private raiders. That's unlikely, given Apple's \$76 billion market cap. You would at least expect to see investor-friendly gestures such as buying back some stock, or paying dividends, as Apple did from 1987 to 1995. Or, a shopping spree. But tech takeovers have a high failure rate, and Jobs is a big believer in the power of small teams and focused operations. He's not going to throw cash against the wall just to become a player in lots of markets.

In the rare cases where Apple does deals, it tends to buy small outfits that can be integrated into projects already under development. In 2002, Apple paid \$30 million for EMagic, the German company behind the Logic program for professional musicians. That led to a popular Mac program called GarageBand. Apple also has used its cash to ensure a solid supply of components. In 2005 it bought up a big slice of the world's NAND flash-memory manufacturing capacity. Those chips are key components in the iPod nano and shuffle.

But now consider another bet Apple could make: What if it took, say, \$1 billion and handed it out to little Apples in the making, through a company-owned venture capital arm?

Plenty of other tech giants have gone the VC route, including Qualcomm, Motorola, IBM, and Intel. Intel Capital has invested \$4 billion in 1,000 companies over 15 years—\$1 billion of that in 2006. Some 160 of those companies have been scooped up by other companies, while a further 150 have gone public. Either way, Intel can cash in. Last year, Intel Capital's

A better way for Jobs & Co.'s hoard to benefit shareholders



investments added \$214 million to the company's net income.

Not every roll of the dice comes up a winner. In fact, Intel Capital's holdings lost a net \$45 million in 2005. But getting richer in the short term isn't the point. Intel's agenda is to use its considerable resources—cash, technical expertise, and insight—to discover and nurture a few dozen brilliant startups. Their success could lead to a new wave of innovation in chip demand down the road.

Imagine what could come of making Apple's cash, together with its technical expertise and business sense, available to a raft of startup companies. If you're a music-software outfit, wouldn't

want guidance from the folks who developed the iPod, the biggest thing in consumer electronics in a decade, or iTunes Store, the single force to contend with in the still-nascent age of digital media distribution? The Mac OS X computing system has more buzz around it than anything else from that company outside Seattle. If Jobs' latest hunch is the iPhone may prove to be even bigger than the iPod.

There are plenty of branches of the Apple tree that could nourishment. Once you get beyond the big names, like Microsoft, Adobe, Intuit, and a batch of others, the most promising names developing Mac software are small companies with limited resources. Gaming on the Mac still lags far behind Windows world. And while there's a healthy industry of \$1 billion or more in iPod accessories, ideas for product around enhancing the iPhone and Apple TV (which send internet video to a TV) are just now taking shape.

Apple hasn't always been this successful. At one point in the mid-1990s it had barely enough cash to keep its doors open for two months. Now, those days seem a long way off. And now it has a chance to use some of its winnings to help other startup entrepreneurs—and enrich shareholders in the process.

Paul and Lois Kolada balanced their priorities in Ohio.

Because his firm is a leading designer of golf clubs — and because he's an avid player — Paul loves Ohio's many first class, affordable courses.



THE KOLADAS' STORY

"We compete very successfully with firms from both coasts. And we wouldn't trade our lifestyle."

Paul Kolada, Principal
Priority Designs

Before Paul and Lois Kolada opened their industrial design consulting firm, they established priorities for both their company and their personal lives. They found a perfect balance in Ohio.

Relocating from Michigan in 1990, they even named their new company, "Priority Designs." It quickly became one of the country's leading new product development firms, taking conceptual product ideas through prototyping and engineering. Priority designs everything from golf clubs to consumer electronics to sophisticated medical devices for well-known clients including TaylorMade-adidas Golf, American Standard, Electrolux, and the Scotts Company.

With a strong pool of talented designers and engineers trained at its excellent universities, Ohio proved to be a wise choice for their business. Real estate costs are reasonable. Overhead is low. And Ohio is a convenient, central base for the company's frequent international travel.

On the personal side, the Koladas found a wonderful place to raise a family with outstanding schools, great neighborhoods and a relaxed pace. Yet big-city cultural amenities, including theater, museums and a world-class zoo, are just minutes from home.

When the Koladas came to Ohio, their priorities were "elbow room, a lack of pretension and the freedom to flourish." That's exactly what they found.

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Wellness—or Orwellness?

Our story about Scotts' controversial health-care plan provoked strong reactions



In their latest bid to control soaring health-care costs, many companies are ramping up their “wellness programs.” Few are pushing the idea as aggressively as Scotts Miracle-Gro in Marysville, Ohio. In our recent Cover Story “Get Healthy—Or Else” (Feb. 26), we described Scotts CEO Jim Hagedorn’s all-out attack on health-care costs. His bold move to audit, in effect, the health of each employee has helped many on his

staff. But some workers found the campaign intrusive. One, Scott Rodrigues, is suing Scotts for wrongful dismissal after he failed a drug test for smoking. (The company says his job offer was contingent upon the drug test.) The story provoked an avalanche of reader commentary. Here are edited excerpts:

» Thank you, *BusinessWeek*, for your article about Scotts Miracle-Gro and their invasive tactics into their employees’ personal lives. It is truly shameful that a corporation makes use of data-mining software to “scour the physical, mental, and family health histories of nearly every employee” to invade their personal lives. I will never buy Scotts’ products again.

Bob Bevill
Merrimack, N.H.

» In many ways, wellness is a measure of personal judgment. If employees won’t take care of themselves, why would the employer assume that they will take care of the company?

Dick Standaert
Colorado Springs

» Alcoholics are refused liver transplants. Drug addicts don’t get dialysis. Morbidly obese are passed over for knee replacements. Do employees deserve employer-subsidized health-care coverage if they’re out of compliance with health? The concept of health care is that the healthy balance the unhealthy in risk assessment and cost analysis. In America, 127 million are fat, 23 million are addicted to drugs or alcohol, and then there are smokers, the

chronically medicated, and chronically ill. Where are the healthy to balance the un-? Hagedorn has it right. Reward, encourage, protect the healthy.

MeMe Roth
President, Action against Obesity
New York

‘REMARKABLE LEADERSHIP’

» I am 55 years old and have been self-employed for most of my working life. So has my wife. Both of us eat well but moderately, exercise regularly, and are trim and healthy. In spite of our excellent condition, we must pay over \$7,800 per year out of pocket for our family’s health insurance plan because 60% of our fellow citizens [are] overweight or obese, drink too much, smoke too much, and exercise too little. I find this infuriating beyond words. My view is that those people should pay out of their own pockets for the health consequences of their sedentary lifestyles. I applaud Jim Hagedorn’s relentless yet engaging approach to enforced employee

wellness and I hope that every company the nation follows his lead.

Tony
Owner, Bay Area Property Inspection
BayMountain Environmental
San Rafael

» Health-care costs are going through the roof. However, throwing out privacy discrimination concerns is not the answer. The answer is to uncouple employment and health care. Every industrialized nation on earth, except ours, puts health care where it belongs: on the national level, as a basic function of government that every citizen is entitled to. Hagedorn has discovered that minor incentives work in changing long-standing patterns of behavior and/or addictions. So have a wellness program tied to insurance and use the money [to lobby] Washington for something that will really solve the problem. That is universal health care.

Victor
Cal

In the early 2000s, Hagedorn, like many other CEOs, watched health-care costs explode. From what he could see, the government and the health-insurance industry weren’t doing anything to solve the crisis.

from “Get Healthy—Or Else”



The real takeaway is that we have yet seen evidence that employers should be part of the health-insurance game. Hagedorn has shown remarkable leadership and passion in his attack on health-care costs, but would his time be better spent attacking competitors or dreaming up more innovative products?

Bob Gilbreath
Cincinnati

[Our] article doesn't address what companies can do to improve their own behavior. Employees are working more hours, have less vacation and sick leave, and their wages are stagnant. These working conditions can place great stress on workers. Stress can promote eating disorders, hypertension, depression, immune-system suppression, and other adverse physiologic changes, which can lead to obesity, heart disease, diabetes, and other negative health outcomes. To bring down health-care costs, it's not enough to encourage employees who need to change their behaviors.

Quimer: Although I am employed at the Centers for Disease Control & Prevention, Health & Human Services, these comments are my own.

Geoffrey M. Calvert, M.D., MPH
Cincinnati

Hagedorn concedes the program had Big Brother overtones. But he's adamant about bringing down health-care costs. 'If people understand the facts and still choose to smoke, it's suicidal. And we can't encourage suicidal behavior.' from "Get Healthy—Or Else"

» Congratulations to Jim Hagedorn for his determined and commonsense policies incentivizing his employees. Jim's decisions are based on the harsh reality that our workforce apparently lacks the basic self-discipline to control its caloric intake and exercise every week. The dramatic effects of today's obese workforce continues to affect our company, with an average yearly premium increase of 30%. It's time to allow the insurance marketplace to segregate based on the lifestyle choices which drive obesity, or we'll all be unable to afford basic health care in a few years.

Dale B. Van de Vrede
Scottsdale, Ariz.

» I strongly applaud Hagedorn's efforts at health-care reform. In my present work environment of 90 employees, one-third of my coworkers smoke and one third are obese. People often take extra breaks to go down to the parking garage and smoke. Office conversations routinely revolve around what fatty and/or fried foods to order for breakfast and lunch. Our company provides an outstanding array of health care programs yet they are routinely disregarded and sometimes openly derided by employees. Employees who do not even attempt to correct their poor health habits are appallingly naive in failing to understand that their lack of responsibility may no longer be shielded by their employers.

Kevin Mulhare
Bridgeport, Conn.

'CREEPY ABUSE OF POWER'

» I am all for incentives for employees to get healthier by cutting back on high-risk products and services. But Scotts wants it both ways. Scotts sells legal, high-risk chemicals that cover grass, then seep into public water supplies. Hypocrisy aside, Scotts' policy goes beyond any respectable American business standard. Scotts employees must submit to regular bodily-fluid tests and divulge their entire family's medical history, which involves those who are not on Scotts' payroll or present to consent. This is not visionary business practice; it is a creepy abuse of power.

Anne Jones
Woodstock, N.H.

EDITOR'S NOTE: Scotts maintains that all medical data are kept strictly confidential.

» Is this just hilarious or is it darkly ironic? Scotts, the corporation that profits by selling countless tons of toxic chemicals for people to sprinkle on their lawns, hassles and later fires a poor sap who fails a "drug test" for cigarettes. I wonder when their "wellness" program will start looking at the health risks to their employees (and the rest of us) who use Scotts lawn products.

Christian Nelson
Rochester, Minn.

EDITOR'S NOTE: Scotts responds that all of its products go through a rigorous regulatory process before they are approved safe for use by consumers.

BRALY

"Consumers are telling us what they want"

Making Health Insurance Hip

WellPoint sees growth selling no-frills coverage to twentysomethings

BY JOSEPH WEBER

ANGELA F. BRALY, THE plainspoken 45-year-old Texan just named to lead the nation's biggest health insurer, loves the Web sites her company uses to reach out to uninsured twentysomethings. WellPoint Inc. targets these so-called young invincibles—generally healthy folks who shun coverage as too costly and unneeded—with images of wild-haired guys and girls sticking out their tongues, sketches of skateboarders, and language like, "You live life on the edge and happily go over it."

The big Blue Cross Blue Shield plan

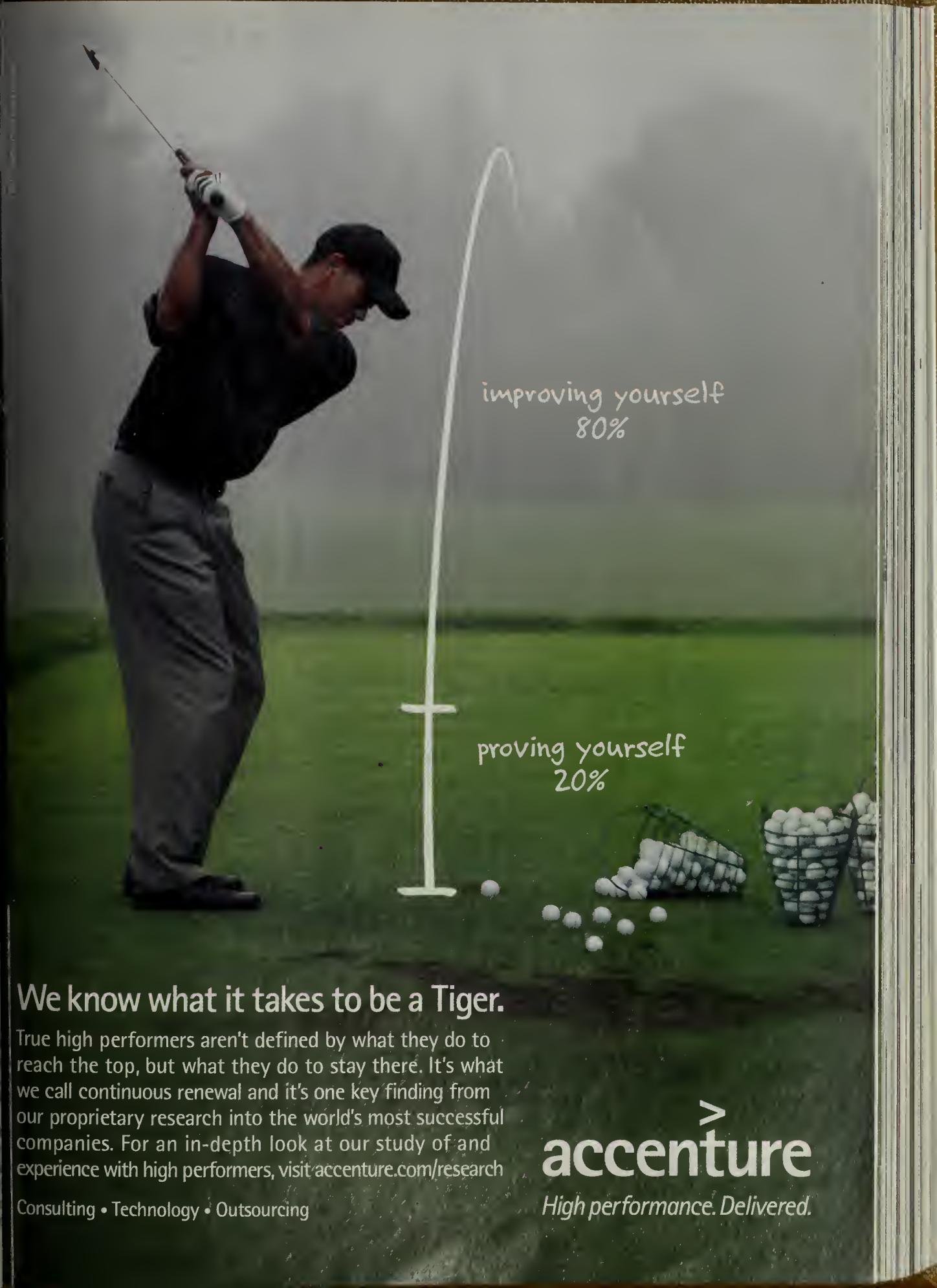
marketer is winning hundreds of thousands of new customers with policies named "Part-Time Daredevil" and "Gravity Bender," offering basic coverage for as little as \$67 a month. The hip sites, says Braly, are helping WellPoint make "significant progress" in bringing health coverage to those who lack it. "Those are cool, don't you think?" Braly crows.

But no matter how clever or colorful, the Indianapolis giant's efforts to shrink the ranks of the uninsured aren't winning universal acclaim. The slimmed-down policies, which omit maternity benefits, for instance, are "obscene," charges one critic. With

them, the company is underinsuring overcharging customers, fumes another. Others say Braly's outfit may win by covering only healthy people, leaving others to government programs. From a public-policy perspective, it doesn't work," claims Dr. Don R. McCann, a senior health policy fellow with Physicians for a National Health Program, who advocates a Medicare-like single-payer system.

Braly, named on Feb. 1, will take over on June 1 for outgoing WellPoint Chief Executive Larry C. Glasscock (J). Her name begs to differ. She's an attorney, currently the





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Insurance

pany's general counsel running p and government affairs. She argues filling the health-care coverage gap take "new and innovative" approach that meet the public's needs and p etbooks. Not everyone needs mate coverage, for instance, and shouldn't asked to pay for it, she says. And d ent groups have different "triggers seeking insurance, she adds, noting Hispanics—another big market . Point is targeting with small-group cies—tend to avoid coverage until have children. "Consumers are telli what they want," Braly says, arguing WellPoint is growing because it liste

Indeed, consumers are snapping the novel policies that WellPoint ma so far mainly in eight states. Sold on like Tonik.com and Soundhealth, they're a hit with those aged 19 to 29 a big part of the way WellPoint has coverage to some 780,000 previ uninsured people in the last two y says Braly. While that's just a fra

**"What if
you have
cancer?"
one critic
asks**

of the na 46 million sured—and c 34.1 million WellPoint co most in Blue in 14 states effort has "incredibly cessful," the designate sa

As the d on health care rages nationally, Wel has thrived, hitting No. 2 on the BusinessWeek 50 list of the best c rate performers. Even if it doesn more Blue Cross Blue Shield opera which is how the once-sleepy \$6 bl a-year Midwestern company grew titan in the past eight years, analy pect its net income to grow by mor 10%, to about \$3.4 billion, as sales above \$60 billion this year. And says WellPoint will be acquisitive.

But it's also a big target, an become more of one as Braly p for a bigger role in the national l care debate. The scaled-back indi policies WellPoint offers under the and Sound brands may cost as li one-third of what employer-based coverage does, but they cover as four doctor visits annually (with cc and carry deductibles ranging as l \$5,000 (or \$10,000 for services c a network).

"What if you have cancer?" ask orah J. Chollet, a senior fellow Mathematica Policy Research Inc



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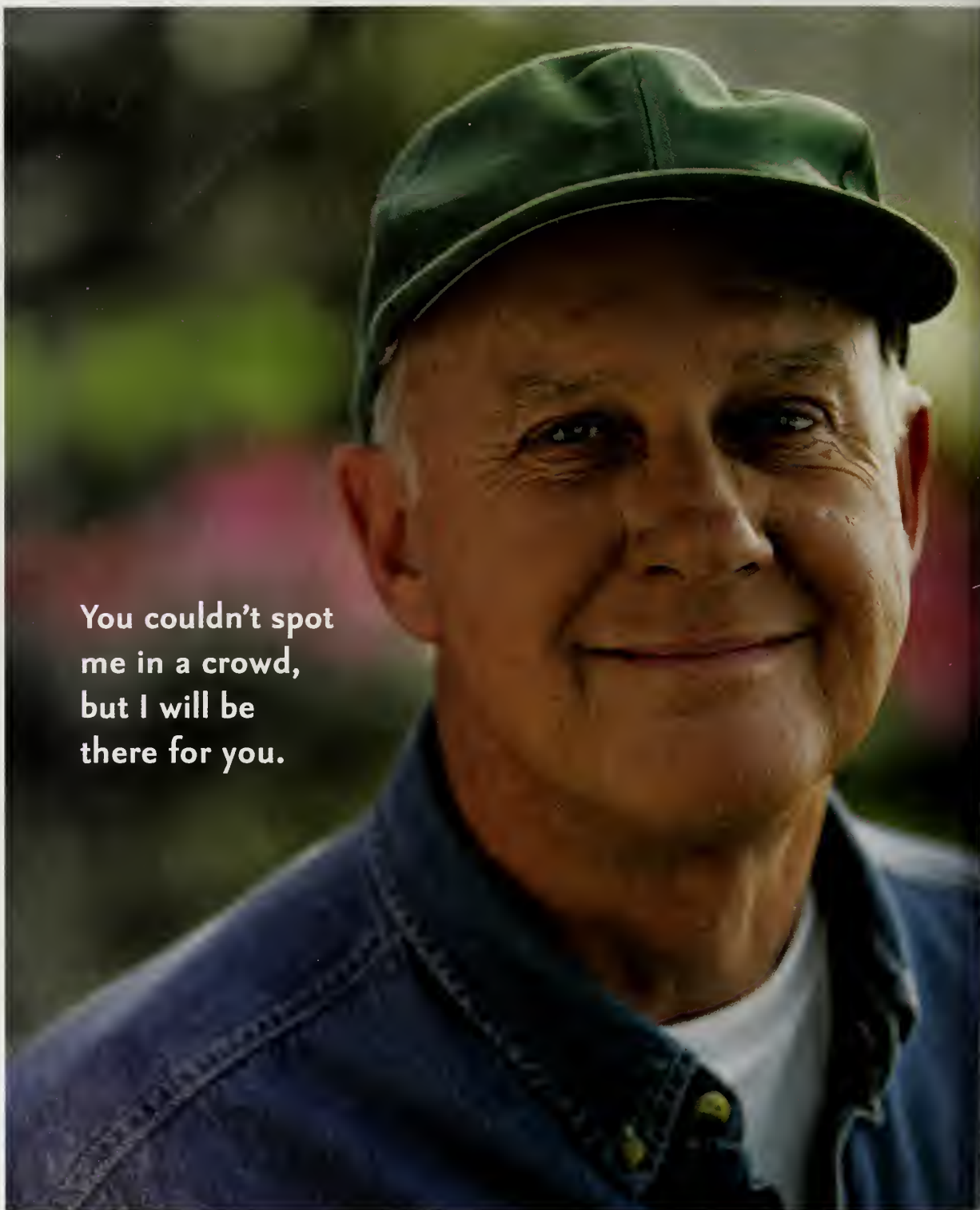
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n Washington. "You face incredible radiation treatments and therapy, and it's guaranteed you're to see a doctor once a week." All es would be covered up to \$5 million the company says, after the patient ne deductible.

skimpy coverage may ultimately n others. Such individual poli-ake young, healthy people out ups—"risk pools" in insurance—that help pay for families' and ne else's coverage. Finely tailor-olicies "segments the risk pool aves older and sicker people in ol with higher insurance costs,"

frets Kathleen D. Stoll, director of health policy for Families USA, a Washington nonprofit that is an advocate for health care.

Still, to some health system players WellPoint's approach makes sense. Is it smarter to keep an unmarried 22-year-old guy uninsured because he shuns pricey benefits that only families need? WellPoint's tailored plan "is cheaper than a lot of products, so of course it's not going to cover as much," says John W. Oxendine, the state insurance commissioner in Georgia and a fan of Tonik. "The key is disclosure, so consumers understand what is covered."

As they age, customers will need fuller coverage. Braly, who earned her spurs running the Missouri Blue Cross Blue Shield plan that WellPoint acquired, says the "Part-Time Daredevils" will move up as they settle down. "If you can really bring more people into the health-insurance market, that's a positive thing," says Paul B. Ginsburg, president of the Center for Studying Health System Change, a policy-study outfit. He admits to mixed feelings about the WellPoint approach.

The challenge for WellPoint will be whether it can provide affordable full coverage for the no-longer-invincibles. ■

EXECUTIVE SUITE

The New First Lady of Health Care

f Senator Hillary Clinton (D-N.Y.), or anyone else for that matter, wants to take on health-care reform, she'll have to deal with Angela F. Braly. She will be the most powerful woman in health care come June, when she becomes executive of WellPoint Inc. Braly will probably be the most powerful woman in corporate America, too. The \$60 billion Anthem will be the largest U.S. company to have a woman at the helm. Those close to the lawyer-by-trade say she'll bring preparation, and political savvy to the fray. She's already sounding diplomatic. "I won't tell politicians what to do, she will insist on a seat at the table in the efforts: "We want to continue to be part of the dialogue."

In a swift eight-year ascent to the corner office, Braly has developed a market-oriented but nuanced approach to the hotly politics of health care. For the record, she says she's "very supportive of things like fitness and wellness programs" in California Governor Arnold Schwarzenegger's plan for mandatory coverage in the state, for instance, but not so enthusiastic about proposed profit caps. President George W. Bush's plans for tax credits for health insurance costs intrigue her, but she wants to make sure we're not dismantling the employer-based system by adopting other changes, such as proposed taxes on benefits. And Braly is a fervent fan of consumer choice, saying

insurers need to be able to tailor health plans to individuals' needs. That approach, of course, is anathema to critics who want government to be a low-cost single payer for health care.

Braly's trial by fire came in 1999, when she joined Blue Cross Blue Shield of Missouri as general counsel and point person for government relations, while the plan was in the middle of a fight over its conversion to for-profit status. It was her first job after practicing law at the St. Louis firm Lewis, Rice & Fingersh, and Braly quickly disarmed the battle's myriad protagonists with a mixture of charm and substance. The settlement that she helped broker created a billion-dollar foundation that has distributed over \$200 million so far to nonprofits aimed at helping the uninsured and underinsured, and it set the stage for the Blue plan to be swallowed up by WellPoint. "She's very bright, very well prepared, and very impressive," says one opponent in that fight, Joel D. Ferber, a managing attorney with Legal Services of Eastern Missouri. "It helps to have

people who are likable in those situations. Tempers flare."

It wasn't long before Braly, a Dallas native who got her law degree at Southern Methodist University and still speaks with a Texas twang, got a crash course in corporate politics, too. In 2002, WellPoint, then a fast-growing California insurer, bought the Missouri Blue plan. Two years later, Indianapolis-based Anthem acquired WellPoint (and took its name). Currently an executive vice-president who oversees the company's Medicare claims unit, Braly emerged as a key strategist in the integration of WellPoint and Anthem under

outgoing CEO Larry C. Glasscock, who will stay on as chairman. Her varied roles helped as the board reviewed succession candidates last spring, with the guidance of management consultant Ram Charan. "She's very much a diplomat by nature," says John J. Riffle, a managing partner at her old firm. "It's just instinct with her."

Riffle also remembers that her capacity for work was exceptional. He would receive e-mails from her at crazy hours when she was trying to juggle the rearing of her three children with her work as a corporate lawyer. Now, with the kids in school, she'll have help from her husband, Douglas, a retired trucking company executive. "You can never wear her down," Riffle says. That's a quality that will come in handy when she's on Capitol Hill.

—Joseph Weber



Braly's rise has been swift: Eight years to the corner office



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Redefining Compensation in Today's Workplace

For today's business leaders, hiring and retaining the best employees has become more and more challenging. Globalization, cut-throat competition, a younger and highly mobile workforce, and a marketplace in which opportunities are always open to top talent, call for a new approach to compensation.

In the traditional view, compensation is a simple salary equation, measured in dollars. The company pays money to its employees and in return receives their services. Higher pay equals a more desirable job.

This view is a carryover from the past. Fifty years ago, the marketplace changed very

slowly. Families often had a single wage earner who sought long-term employment and was loyal to the company. Companies, in turn, offered stability to their employees by providing health-care, retirement, and other benefits, in addition to a paycheck.

In today's world companies need a more expansive view of compensation. People still care about how much they're paid, and yes, the traditional salary equation still has relevance, but many elements of compensation are no longer easily quantifiable in dollars (or yen or euros).

Today, wage earners want quality of life. They need flexibility. They search out the

opportunity for alternative work schedules, telecommuting. Increasingly people recognize that resolving conflicts between their work and personal lives is essential to health, happiness, and productivity.

Employers need to know why employees join a company, why they stay, and what makes them productive. Employers must determine how to modernize their compensation strategies in a way that benefits the bottom line. Traditionalists will always favor this expanded definition of compensation. The old equation, after all, worked well for a long time. But companies that ignore changes in the employment landscape will likely face a future of recruitment, retention and productivity issues, resulting in low growth and weak profits.

To read the full report, go to
www.expert-insights.com/ceridian.asp



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New Economy Web and Voice Tools Improve Customer Experience, Sales

It's no secret that customer service is a key challenge for companies doing business online. Now, new tools that marry Web and voice technologies can improve how your business connects with customers and increase the sales effectiveness of your Web site. Until recently, these technologies came with large price tags and lengthy contract commitments. But that's changing – and your business is the beneficiary.

The Internet is where most customers first go for product and service information. These days it's all about making your Web site more customer-centric. Therefore, the ability to solve sales issues and provide customer support through a live sales agent is a mission-critical initiative, not just an added feature.

Web-initiated "click-and-connect" technology now makes it easy to install a Sales Agent or Customer Service button on Web pages so customers can do business with you by phone – easily and conveniently. When customers click the button, they are instantly connected – via their regular home, office or mobile phone – with the customer service or sales agent. This level of access increases sales conversion rates and reduces shopping-cart abandonment.

The benefits of Web-initiated calling also extend beyond Web sites. For marketing and sales executives, public relations practitioners, and other professionals, adding a click-and-connect button to outbound emails improves response rates. In addition to

live phone leads, Web-initiated calling delivers online marketing analytics that enable advertisers to track the effectiveness of campaigns in real-time.

Click to
Call Us
Now!



Click-and-connect technology requires no front cost and it's easy to install: simply create an account online and paste HTML code into your site or email signature. You pay pennies per call. And the return on investment is immediate.

The more you improve the customer experience, the more you'll improve sales. Now all it takes is a click to take advantage of Web-initiated phone sales and reap the rewards. Just click...and

To read the full report, go to
www.expert-insights.com/jaduka.asp



Jaduka provides tools and technology that empower businesses to acquire and retain customers. The company's Web-enabled telecommunications services enable customers and online community members to simply click a button to instantly talk on the phone or privately exchange information. Dallas, Texas • Tel: 800.880.5910 • www.Jaduka.com

EXPERT INSIGHTS*Reports on Employee Incentives
& Human Resource Management*

To read full reports and related information, go to the links listed below or visit www.expert-insights.com

Best Company Performance & Profitability with Employee Incentives

Maximizing company performance and maintaining a competitive advantage are two of the most important goals in today's business environment. As performance standards are ever-increasing, managers face some incredible challenges. If their employees are actively engaged in contributing to the company's overall success, they can more easily tackle the question of how to increase employee performance and productivity while keeping overall costs down. Many managers feel that offering cash incentives are the easiest and most economical fixes to achieve their goals. However, a study performed by the Incentive Federation in 2005 points out that 60% of employees see cash as a part of their compensation

package - an increase of 3% over 2003.

What are managers to do if over half of their employees feel that they are "owed" cash, and that it is expected? What enticing ways are there to increase performance while keeping the budget in check?

Chart 2.12E Respondents Perceiving Cash Payment is Part of Remuneration Package



A 2003 study from the Society of Incentive & Travel Executives (SITE) Foundation, found that employee performance is markedly better when in

pursuit of a non-cash incentive (such as merchandise, gift certificates and travel). Participants working toward a non-cash incentive improved performance by 38.6%, while there was only a 14.6% lift created by a cash incentive.

It's not only the reward; another key element of incentive compensation is structuring a program that keeps employees excited, motivated and productive.

So how does one get started? According to the 2005 Incentive Federation study, the most common objectives for non-sales recognition/motivation programs are: better customer service, build morale, foster teamwork, and obtain ideas or suggestions. Recognizing what motivates and inspires employees to excel combined with a well-designed incentive/compensation package, and managers are sure to see performance and profitability rise.

To read the full report, go to
www.expert-insights.com/rymax.asp

This report was written by Kara Sibilia, Senior Director of Project Marketing for Rymax Marketing Services, Inc. Rymax, an industry-leading provider of merchandise incentives, understands the important role incentives play in increasing a company's bottom line. Rymax offers luxury products at factory-direct prices - meaning that clients receive the best value for their money - and also develops customized incentive programs to help businesses maximize performance. Clients count on Rymax to execute motivational programs utilizing the best branded merchandise. For more information, visit www.rymaxinc.com/businessweek or call (866) 879-2807.

Payoffs of Employee Engagement

Companies that invest in a culture of engagement realize measurable dividends, including top rankings, a positive company culture, and strong individual performance - all key drivers of productivity and financial success. So why are companies spending up to \$300 billion annually to retain disengaged, passive employees? Human resource professionals cite a lack of training, education and resources to address the issue. Companies may not understand how to influence employee engagement or measure the intangible results, they undervalue the dividends that engagement brings to the bottom line. The results are lower productivity and affect revenue, product superiority, innovation, and customer relations.

Engaged employees are typically highly motivated and involved with their work. They are committed to the organization and the success of co-workers, which inspires others. These individuals are naturally oriented toward good customer service and optimistic about accomplishing goals.

The Significant Dividends of Engagement

- 1. People Power.** Retaining top talent equates to less dollars on recruiting and training. Building a sustainable culture requires stability and low attrition.
- 2. Positive Outcomes.** Engaged employees create positive outcomes. They are a magnet to other people, refer employees, and build relationships. Engaged employees create engaged customers, and this drives repeat business.

As more companies place higher priority on engagement, there is a greater need for proactive tools. A key success factor includes tailoring your recruiting and screening practices to identify the candidate characteristics that deliver engaged employees from day one.

Three Ways To Improve Engagement

- 1. First Things First.** Begin with tailored recruitment and screening efforts. If this is not an area of core competency, enlist a staffing partner to target key candidate qualities.
- 2. Get an Outside Perspective.** Enlist an outside consultant for an unbiased assessment of your current level of employee engagement and strategies that would best support your company's goals and culture.
- 3. Shared Focus.** A tandem effort between human resources and management is an essential component of successful engagement strategies.

To read the full report, go to
www.expert-insights.com/HRsolutions.asp

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HR Solutions is a leading staffing partner, providing tailored search, contracting, and consulting services in northern and Southern California since 1990. Dedicated to building long-term relationships, HR Solutions specializes in representing qualified human resources professionals for direct-hire, contract and consulting positions with companies of all sizes. For more information visit www.hr-solutions.com.

Open-Air Hardtops

Metal-roofed convertibles are sturdier, safer, and offer better handling and a dramatically quieter ride than most ragtops. **BY MATT VELLA**

BEACH BIMMER

BMW 328i Convertible

BASE PRICE: \$43,975

ENGINE: 3-liter inline-6

POWER: 230 horses

EPA MILEAGE: 20-30 mpg

TRUNK SPACE (UP/DOWN):
9 cu. ft./4.8 cu. ft. (est.)



WHO DOESN'T LOVE A CONVERTIBLE? With the top down, that is. But when a conventional ragtop is closed, it can be noisy inside. The soft roof also may not wear well or offer much protection in a crash.

Hardtop convertibles resolve such problems. And now there's a raft of new metal-roofed open-air roadsters and coupes ranging in price from around \$20,000 to well above \$100,000.

All of them, from the lowest-cost Mazda Mx-5 to the ultra-luxurious Mercedes-Benz SL550 Roadster, open in seconds. Just push a dash-mounted button and, thanks to a complex system of motors and tightly choreographed metal origami, the top tucks neatly away behind you.

Hardtops offer improved durability and greater safety than ragtops. Closed, the cabins are dramatically quieter, too. And because of their more rigid underlying body structures, most handle better

The trade-off for a sturdier roof and easy open-



IF MONEY IS NO OBJECT
Mercedes-Benz SL550

BASE PRICE: \$95,575
ENGINE: 5.5-liter V-8
POWER: 382 horses
EPA MILEAGE: 14-22 mpg
TRUNK SPACE (UP/DOWN):
10.2 cu. ft./7.3 cu. ft.

GO FOR THE BUCK
Volkswagen EOS

PRICE: \$27,990
ENGINE: 2-liter 4-cylinder turbo
POWER: 200 horses
EPA MILEAGE: 23-32 mpg
TRUNK SPACE (UP/DOWN):
5.1 cu. ft./6.6 cu. ft.



BUDGET THRILL MACHINE
Mazda Mx-5 Miata

BASE PRICE: \$24,945
ENGINE: 2-liter 4-cylinder
POWER: 166 horses
EPA MILEAGE: 25-30 mpg
TRUNK SPACE (UP/DOWN):
5.3 cu. ft./5.3 cu. ft.



close is cramped cargo room. With the top
ned, trunk space in most of these models is cut
hlf, and on most smaller roadsters it's virtually
nnated. The sole exception is the Miata—it loses
n inch of cargo room when it goes topless.
The new hardtop convertibles are technological
rorders. Automakers are looking to these models
create excitement in the showroom even if most
stomers are likely to drive off in more practical
es. Here's a sampling of sporty vehicles with pow-
er-folding hardtops for just about any budget.

BusinessWeek .com

WISH LIST: For a look at the latest hardtop convertibles,
see our slide show at www.businessweek.com/extras.



BY MIKE MARRONE

Just as Sly As He Ever Was

 THIS YEAR MARKS THE 40TH ANNIVERSARY of what has long been referred to as “The Summer of Love,” the magical year 1967, of *Sgt. Pepper* and wearing flowers in your hair. As such, it’s also the 40th anniversary of the release of *A Whole New Thing*, the first album by San Francisco’s Sly & The Family Stone. In honor of that milestone, Epic/Legacy has lovingly remastered and repackaged the seven albums the group recorded for the label from 1967 to 1974.  Sylvester Stewart has

already made a name for himself by the time he enlisted his brother Freddy, sister Rose, and cousin Larry Graham and formed one of the first (and certainly most successful) multiracial rock groups, with drummer Greg Errico, Jerry Martini on sax, and Cynthia Robinson on trumpet. He changed his name to Sly Stone in 1963 when he became a San Francisco R&B disc jockey who mixed in the rock of bands like The Rolling Stones and The Beatles with rhythm and blues. From 1963 to 1966, he also produced artists such as The Beau Brummels and The Mojo Men for the Bay Area’s Autumn Records label, which was started by progressive radio pioneer “Big Daddy” Tom Donohue. Young Sly even produced Grace Slick’s original version of *Somebody to Love* with The Great Society, her band before Jefferson Airplane.

Sly Stone went on to create a body of work and a completely new sound that has stood the test of time. We all know the hits—*Dance to the Music*, *I Want to Take You Higher*—and can name them in seconds when we hear them start to play. But digging into the albums, even all these years later, yields nugget after golden nugget. The influence of his work on popular music to this day cannot be overstated.

Each of the discs is expanded with bonus tracks and will be released on Apr. 10 in a limited-edition, numbered run, both individually and collectively. There are 21 previously unreleased tracks in all, including instrumental outtakes, mono single versions, and B-sides.

A FEW SELECTED HIGHLIGHTS:

A Whole New Thing (originally released in November, 1967) Listen to *Trip to Your Heart* for a hint of things to come.

Dance to the Music (April, 1968) The mono single version of the title track is

included, as well as a previously unreleased cover of Otis Redding’s *I Can Turn You Loose*.

Life (November, 1968) This album, my personal favorite, *Jane Is a Group* is the hidden jewel in the catalog.

Stand! (April, 1969) The big breakthrough album, most fans will pick this one up first. Five bonus tracks added, including the original mono single mixes of the title track and *I To Take You Higher*.

There’s a Riot Goin’ On (November, 1971) This is a timeless masterpiece essential to any well-rounded collection. A new version of *Family Affair* (by John Legend and Joss Stone with Van Hunt) won Grammy this year for Best R&B Performance by a Duo or Group with Vocals. You won’t find that remake here, but you will get the original, as well as bonus tracks, including the mono single mix of *Runnin’ Away*.

Fresh (June, 1973) My gem is *Babies Makin’ Babies*, and an alternate version is included among the five bonus tracks.

Small Talk (July, 1974) This final album was a solid effort. *Loose Booty*, *Tim Livin’*, and the title track are here, in addition to four bonus tracks. ■

Mike Marrone is program director of XM Satellite Radio’s *The Loft*, a channel that on an eclectic mix of singer-songwriters from the 1960s to today.

STONE IN '73





BY ROBERT PARKER

Margaux Beyond Château Margaux

COULD PAY \$150 for a bottle of Château Margaux, one of the elite, first-growth producers in one of the most famous appellations in Bordeaux. But you can get world-class wines from other Margaux châteaux that sell in the \$100-to-\$50 range. With these wines, the relatively low prices don't reflect quality. Look for the 2000, 2001, and 2003 vintages, and the 2004s and 2005s when they become available. Here are some châteaux to put on your list:

Cantenac
Known but often ignored château, Cantenac has been producing elegant, black-currant-scented, full-bodied, aromatic wines. Although somewhat overlooked for the Margaux appellation, they are concentrated as well as potentially long-lived (20 or more years).

Lascombes
One of the largest vineyards in Bordeaux, Lascombes has been resurrected over the past decade, turning out sexy, up-front wines offering gorgeous aromas of incense, blackberries, licorice, smoke, and more. This opulently styled wine is often showy at a young age, but it will continue to be drinkable for the next 20 years.

Lascombes
Thanks to the efforts of Marie-Cécile Schyler, Kirwan is now producing powerful, rich, pure, and long-lived wines. The efforts meant for long-term aging: edolent of black cherries, black cassis, and spicy new oak, the wines are capable of lasting three decades or more.

Lascombes
Of Margaux's more flamboyant wines, Lascombes offers a mix of aromatics of spring flowers, black rocks, espresso roast, charcoal, blackberries, and blackberries. It is drinkable when young but seems to have enough opulence and richness to last for two to three decades.



Malescot St.-Exupéry
Always restrained and never full-

bodied, Malescot St.-Exupéry wines have an intense flavor profile and almost ethereal aromatics of red and black fruits intermixed with black tea, truffles, coffee, and spices.

Prieuré-Lichine
These wines are meant for immediate gratification, not long-term aging. Prieuré-Lichine offers a gorgeous, up-front perfume of ripe fruit, spicy oak, and flowers followed by a supple-textured, lush, velvety-styled wine that is hard to resist.

Rauzan-Ségla
Under the ownership of Chanel, the perfume/fashion house, Rauzan-Ségla has been resurrected and returned to its proper place in the Bordeaux hierarchy. The wines exhibit powerful tannins and an unmistakable mineral component. However, this is among the most restrained styles of Margaux. These wines are meant for true connoisseurs, and most top vintages, such as 2005, 2004, and 2001, require 5 to 10 years of cellaring before reaching their full potential. ■

Robert Parker is the world's most influential wine critic. Visit eRobertParker.com to see tens of thousands of tasting notes, buy his books, or subscribe to his newsletter, The Wine Advocate.



Not Just for The Needy

Why schools are giving more scholarship money to affluent kids

BY LYNN O'SHAUGHNESSY

THE STICKER price of some colleges and universities now rivals the \$210,000 cost of the most expensive American high school, and even wealthy families feel the pain when they start writing those large checks. But affluent parents shouldn't assume their kids will have to pick up the tab by themselves. Far from

A growing number of top schools have begun handing out wads of cash to households that don't appear to need it. Why? "We're looking for families, who have students who are desirable because they prop

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school's profile in the college rankings, and they can also pay a significant portion of their education," says Deborah Fox, president of Fox College Funding in San Diego, a firm that advises higher-income families on strategies to apply for college funding.

CARVING UP THE PIE

THIS RUSH TO offer financial carrots to kids from places such as Greenwich, Conn., Lake Forest, Ill., and Newport Beach, Calif., is a dramatic departure from the 1990s when a handful of brainiacs might capture a college's meager lineup of academic scholarships while everybody else either paid the full freight or queued up for financial aid. Today, colleges that routinely awarded promising but financially needy students full rides of \$30,000 or \$40,000 a year might carve up some of those packages among three or four well-off academic achievers. They figure that tossing \$10,000 a year to an affluent kid from the big city or suburbs might be enough to elicit an acceptance.

Colleges bearing scholarships aren't interested in academic slouches. The student must be an above-average ap-

plicant among those vying for admission to a particular school. At some institutions, that will require an "A" average, but at others "B" students with an SAT score barely above 1000 could walk away happy. Teenagers who are determined to get into a "reach" school, where they barely qualify for admission, are likely to get nothing in their stockings.

Statistics show just how deeply schools are discounting tuitions. Private schools currently offer average tuition breaks of 33.5%, according to the College Board. In states such as Virginia and Ohio, discounts are hovering around 48%, says Paul Hamberg, vice-president at Human Capital Research in Evanston, Ill., which advises colleges on enrollment strategies. The practice also extends to state universities, which give average tuition breaks of 14.7%.

Another recent study by the nonprofit Education Trust found that at 50 state

flagship institutions, the amount of grant aid pocketed by families making at least \$100,000 jumped 406% from 1995 to 2003, while money earmarked for those with household income less than \$20,000 dropped 13%.

"Many of these flagship institutions have become more and more enclaves for the most privileged in their state's young population," the study noted.

The sons of Robert Band, a CPA in Natick, Mass., are beneficiaries of college largesse. When finishing his lineup of scholarships, Band's oldest son, who wants to be a politician, narrowed his choices

to Muhlenberg College in Allentown, Pa., and Union College in Schenectady, N.Y. Each offered \$12,000 a year. The "A" student who scored 1300 on his SAT test. Now 22, Eric is a senior at Muhlenberg, where regular tuition is \$30,715 a year. When his brother Matthew, now 20, whose test scores and grades were a tad lower, started his search, he also targeted schools that were known to offer free cash. He ultimately pocketed a total package of \$50,000 from Quinnipiac University in Hamden, Conn., after Hofstra University in Hempstead, N.Y., made a minute bid to sweeten its offer. Now a sophomore at Quinnipiac, his annual tuition runs \$28,720.

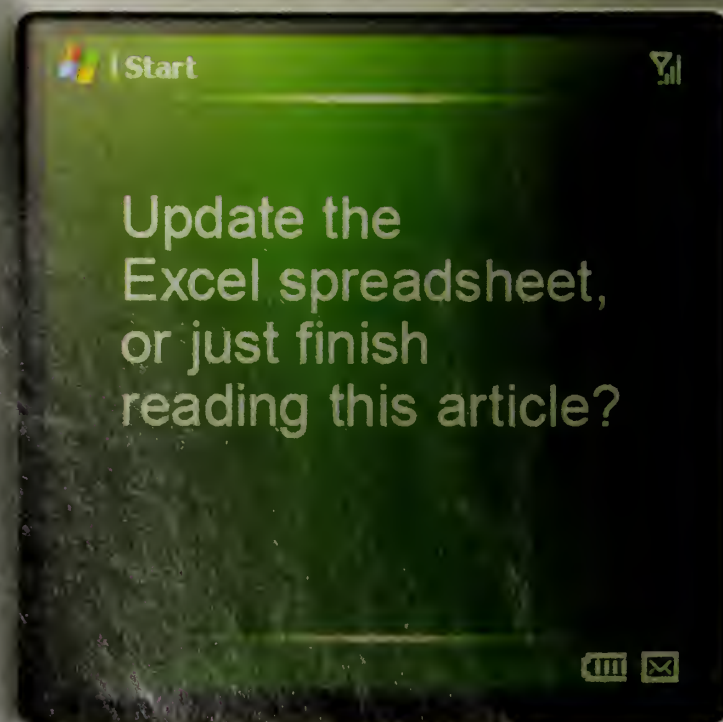
To find out about a school's generosity quotient, check its Web site or call the admissions office for scholarship requirements (table). Popular college resource guides often include information on merit money—also called non-need-based aid—and the College Board's site, collegeboard.com, features student profiles of thousands of institutions to help you determine whether you have the best chance of getting in. You'll find a list of roughly 100 scholarships in a slim book entitled *A's and B's of Academic Scholarships* by Anna Leider.

If you're looking to pay who's prices for your child's college education, consider the following strategies.

IGNORE THE IVIES. Schools with renowned pedigrees, such as Harvard, Yale, Princeton, and Massachusetts Institute of Technology, enjoy the luxury of offering their financial aid for truly needy kids. If your child wants some cash

Money earmarked for low-income students has declined in recent years

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Where the **Largesse** Lies

S
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na Leider
meron Associates)

ook lists about
00 scholarships
ng from \$200 to
00 and offered by
colleges and
ities.

ews & World Report
ate College Guide,
edition.

An encyclopedic reference that includes thumbnail sketches of 1,450 schools, it shows the percentage of students at a college who receive merit aid and the average award. Check with schools to make sure the percentages are accurate.

WEB SITES

College Board
collegeboard.com

Peterson's
petersons.com

The Princeton Review
princetonreview.com

They provide an academic profile of the freshmen at each school, including a breakdown of grade-point averages. The College Board and Peterson's also share the SAT and ACT scores that represent the middle 50% of the students. If your child's scores are better than this, there could be a chance for merit money.

may have to leave a little prestige
able.

in no way means settling for
rate choices. Oberlin College in
Ohio, and Washington Univer-
St. Louis are active scholarship
ers. So is Tulane University,
was slashing tuition by nearly
r sought after students even
Hurricane Katrina smashed into
eans, says Hamborg of Human
Research. "If you're a wealthy
he adds, "you could be looking
% discount at middle-market
t colleges like Providence Col-
rhode Island, Fairfield Univer-
onnecticut, and St. Michael's
g in Vermont."

FORGET THE FLAGSHIPS. Using
dollars, public universities are
eager to attract smart, affluent
ilary Carroll, 19, a National
scholarship finalist from North
on, N.H., discovered this when
received full-scholarship offers
University of Florida and the
ty of Oklahoma. Carroll enter-
d plenty of private school suitors,
dig Cleveland's Case Western Re-
University, which offered nearly
0 a year. Carroll, who is now a
mn, ultimately decided to attend
ee College in Easton, Pa., where
eived a scholarship of \$8,000 a
T compete with the private col-
c the academic as well as the
ci front, public institutions such
olrado State University, Texas
University, Indiana University, the
ry of Arizona, and the Univer-
f Washington are offering strong
s programs.

EXPLORE OUTSIDE YOUR REGION. Many
schools are delighted to see students
who hail from two or three time zones
away. "If you live in California, schools
in the South, East, and Midwest are
looking for students from the West,"
says Eric Goodhart, director of Pro-
grams for Education in Lunenburg,
Mass., who advised the Band family.

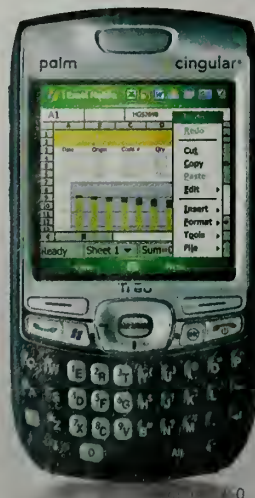
Colleges are less likely to shower an
applicant with money if they sus-
pect they aren't being taken seriously.
That means you or your child should
visit a campus before sending in an
application. If that's not possible, the
student—not the parents—should con-
nect to a school through e-mails and
telephone conversations.

APPLY FOR FINANCIAL AID. "Always,
always, always apply, even if you make
\$250,000 a year," advises Frederick
Rugg, author of *Rugg's Recommendations on the Colleges*. Some schools
won't award your talented kid any
merit money unless you've filled out
the federal aid form, Free Application
for Federal Student Aid (FAFSA), as
well as the CSS/Financial Aid PRO-
FILE, which is used by hundreds of
private schools and which asks a lot
more prying questions.

Parents may be reluctant to divulge
their net worth. Even if your child
doesn't qualify for aid, however, it
still couldn't hurt to let a cash-hungry
college know about the retirement ac-
counts, the family trust, and the sum-
mer home in Telluride. ■

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Microsoft



With Excel® Mobile, you can create, view, and
even edit spreadsheets right on your device.



The Trade-Offs For Free E-Trades

Deals from online brokers can include high minimums, limits, and hefty fees for busy players

BY AARON PRESSMAN

IN THE PAST THREE YEARS leading e-brokers E*Trade Financial and Fidelity Investments have slashed their commissions on stock trades to as little as \$7, prompting many observers to wonder: How low can they go? Now three rivals have come back with a surprising response: How about free?

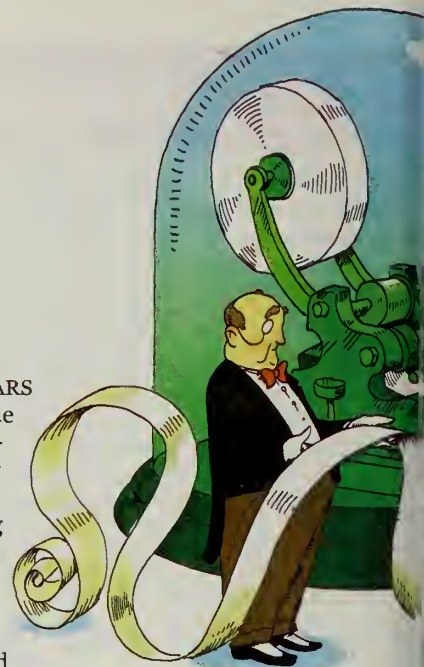
Bank of America, Wells Fargo, and upstart broker Zecco.com have each started hawking \$0 trades to lure online brokerage customers to their portals. They each have their appeal. The online offers at Bank of America and Wells Fargo make the most sense for current customers. Do-it-yourselfers who don't

need a lot of extras may find a niche at Zecco. But don't be blinded by deals du jour. The free-trade offer comes with trade-offs.

For one, you may need to come up with a lot of cash to qualify for the \$0 trade. BofA requires a minimum of \$25,000 in assets outside of a brokerage account in checking, savings, or money market deposits at the bank. And if you have \$50,000 in your brokerage account, you'll need to pony up \$50 twice a year, with a few exceptions. Wells also has a \$25,000 minimum, but it counts your brokerage assets, credit card balances, loans, and up to \$100,000 in mortgages, assuming you have them. If you don't maintain the \$25,000 balance, Wells levies a \$25 tariff each month.

As an online-only broker, Zecco has such stiff requirements. To take advantage of Zecco's deal, you'll need to deposit \$2,500. And you won't get the \$0 trades if your account falls below \$2,500, making it one of the better deals for investors who are just starting out and don't have a big nest egg.

Not surprisingly, commission-free trading doesn't mean unlimited trading. BofA, Wells, and Zecco all impose caps and charge extra for trades beyond the monthly or yearly allowance. Zecco is by far the most generous, offering 40 free trades a month and no charge for more than 10 trades in a single day. That compares with 30 a month at BofA and 10 at Wells. After that, commissions



Your potential. Our passion.™
Microsoft®

Send an e-mail
to your office,
or maybe
send one
to the editor.

The Fine Print

E-BROKER	MINIMUM ASSETS*	NO. OF FREE TRADES	COST FOR EXTRA TRADES	COST FOR TRADES BY PHONE	FEE FOR NO-LOAD FUNDS
ZECCO.COM	\$2,500	40/month	\$3.50	\$19.99	\$10
BANK OF AMERICA	\$25,000	30/month	\$5 to \$10	\$42.50	0.6% to 0.2%**
WELLS FARGO	\$25,000	100/year	\$5.95	\$25	NA

*May include nonbrokerage assets

**For funds outside the list of 1,300 no-fee offerings



nity," it has opted to emphasize bloggers instead. Zecco's main Web page, which includes market headlines and financial data, links to relevant posts from both well-known bloggers and homegrown ones at the site. The quality of Zecco's bloggers is uneven. Dave Fry, founder of ETF Digest, posts detailed charts tracking trends in the world of index funds. But Joe's Money Blog does little more than compile the release dates of economic data that may affect foreign currency prices.

Still, Zecco offers the best bang for the buck—or rather no buck. Its deal doesn't appear to be a teaser that will disappear in a few months. Zecco contends that \$0 trades are part of its long-term business

\$3.50 to \$10.00 a trade. Remember, applies largely to Internet trades. want to buy or sell a stock via a broker on the phone, it costs extra. is the cheapest at \$19.99.)

isn't part of the vocabulary for mutual fund investors, either. Both offer a limited list of no-transaction funds, including 1,300 at BofA, 1,000 at Wells; Zecco charges \$10 a trade for no-load funds and doesn't charge for load funds.

CODED FIELD

BIGGEST KNOCK against these sites is that they simply don't stack up to upgraded brokerages like Fidelity, Charles Schwab, and TD Ameritrade. Many customers get free access to stock research reports from a dozen firms, including Lehman Brothers, Standard & Poor's (like *BusinessWeek*, a division of The McGraw-Hill Companies), and Prudential Equity Group, while E*Trade provides even outfits, such as independent Woodhale Research. Wells provides reports from S&P and Argus Research. Bank of America offers only S&P.

One of the three "free" sites allows investors to trade overseas stocks directly on non-U.S. exchanges. E*Trade charges a flat-rate commission of \$20 on such trades compared with \$100 or more at other brokerages.

When it comes to research, Zecco can't play the Wall Street game at all. In itself "the free trading commu-

model, which relies on advertising dollars and profits from interest on cash and margin accounts as well as premium services such as options trading to make money.

Some investors might question whether a small, new firm like Zecco would be able to handle a crush of orders in a market meltdown. It's a legitimate fear, but bigger players are hardly immune to such glitches. Investors faced delays of more than 60 seconds when placing trades at the Web sites of Fidelity, Vanguard, BofA, and Wells late in the afternoon of Feb. 27 as the market tanked, according to technology research firm Gómez. Yet E*Trade customers and those of smaller online brokers like TradeKing and thinkorswim didn't notice a thing.

Zecco is too new to have been included in the Gómez survey, but the online brokerage says it had no problems that day. So at least in this case, it was worth going with the little guy. ■

BusinessWeek weekend

TELEVISION: For more on commission-free trading, watch our weekly TV show, *BusinessWeek Weekend*. Check your local listings or go to www.businessweek-weekend.com to see video clips or type in your Zip Code to see when and where it airs in your area.

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All Eyes On the Net

Baron iOpportunity's chips are on tech stocks

BY LAUREN YOUNG

FUND MANAGER: *Michael Lippert, 40.*

TENURE: Analyst since 2001 and lead manager since early 2006.

FORMER LIFE: Partner at Baker & Botts, specializing in intellectual-property law.

STOCK THAT EXCITES ME: *Apple*

"The new iPhone can grab a 5% or 10% market share. The switch to Intel chips will create faster computers with easier-to-use software. Macs don't have security problems.... That gives Apple an enormous opportunity."

NEWCOMER TO THE PORTFOLIO: *LivePerson*

"It makes software that allows company reps to chat with customers online. It launched a new product that helps convert clicks into sales. I've been following the company for three years, but I didn't own it until last December."

COMPANY I'VE AVOIDED: *Amazon.com*

"It's hard to be a unique general merchandiser on the Web, especially because of the phenomenon of shopping search engines which let consumers find the best price. Revenue growth has accelerated, but margins are going down. The company is buying growth by offering free shipping and is spending heavily on sales and marketing."

CURRENT READING: *Confessions of an Economic Hit Man* by John Perkins.

AFTER HOURS: Plays in a basketball league. Training for his first triathlon. ■

LIPPERT High on Apple, down on Amazon

BARON IOPPORTUNITY: VITAL SIGNS

Symbol: BIOPX

Category: All Cap

Assets: \$170 million

Sales charge: None

Expense Ratio: 1.44%

The Goal: Find companies whose growth is driven by the expansion of the Internet and information technology

Number of stocks in fund: 52

TOP FIVE HOLDINGS

COMPANY	% OF NET ASSETS
GOOGLE	4.1*
CHARLES SCHWAB	3.9
EQUINIX	3.8
APPLE	3.7
CHICAGO MERCANTILE HOLDINGS	3.5

*Through Jan. 31 Data: Baron Capital Inc.

HOW IT COMPARES WITH ITS PEERS



*APPRECIATION PLUS REINVESTMENT OF DIVIDENDS AND CAPITAL GAINS BEFORE TAXES, THROUGH MAR. 2

Data: Standard & Poor's

Our potential. Our passion.™

Microsoft®

windowsmobile.com



Treo 750

Windows Mobile®. The only way to get mobile versions of Microsoft® Office software. Use Outlook® e-mail, edit Excel® spreadsheets, and modify Word documents. Now when, where, and how you work is entirely up to you. Learn more at windowsmobile.com



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BY GENE G. MARCIAL

A BIG OVERHAUL MAY BRIGHTEN THE OUTLOOK AT HOME DEPOT

FROM HYTHIAM, PROMETA BRINGS NEW HOPE TO ADDICTION.

FOR BUMPER CORN CROPS, FARMERS SPREAD MOSAIC FERTILIZER

Remodeling Home Depot

HOME DEPOT (HD), promising to fix itself up under new CEO Frank Blake, got cheers from investors, who welcomed the \$90 billion company's honesty in admitting it needed turning around. Sales for fiscal 2007 will be flat, or up just 2%, Blake told investors and analysts on Feb. 28. He'll plow \$2.2 billion into the world's No. 1 retailer of home improvement goods. A few months ago, Fidelity Investments dumped 7.1 million shares, and Barclays sold 31 million. After rising from 33 last summer to 41 in mid-February, the stock has dropped to 38.71. "All the bad news—the housing slump and earnings shortfall—is already in the stock, and we think it's very undervalued," says Douglas Davenport, president of Atlanta Investment Counsel, adviser to the Wisdom Fund, which owns shares. Home Depot is the cheapest in its group, with a price-earnings ratio of 14, vs. 15 for Lowe's and 21 for Costco, notes Davenport, who has a 12-month target of 46. Joseph Feldman of Telsey Advisory Group calls Home Depot an enticing turnaround story. He is convinced Blake will succeed. Brian Postol of A.G. Edwards says Blake is too downbeat in saying earnings will drop 4% to 9% next year. Postol doesn't buy it but has reluctantly trimmed his estimate from \$3 to \$2.76 a share for 2008 and from \$3.40 to \$3.06 for 2009. Even so, "we find the shares appealing," says Postol, with a buy/aggressive rating.



How Hythiam Will Tackle Drink and Drugs

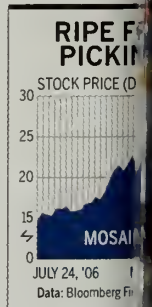
WITH ALCOHOL AND DRUG abuse continuing to be a nationwide scourge, some investors are hopeful that Hythiam's PROMETA may help curb the problem. Hythiam (HYTM) licenses PROMETA to treatment centers, managed-care providers, and government agencies. Using a combination of nutritional supplements and Food & Drug Administration-approved oral and intravenous medications, PROMETA can reduce cravings and promote abstinence, say analysts. Although still controversial, "early results from open-label studies and drug court trials have been overwhelmingly successful," says Ryan Daniels of William Blair, which has done banking for Hythiam. Daniels, who rates Hythiam a buy,

says licensees and clinical researchers express "strong satisfaction with, and belief in, the protocol." Donald Hooker of UBS (it did banking for Hythiam) says his buy rating, with a 12-month target of 15, is centered on "the clinical efficacy of PROMETA." Its stock doubled, from 4.77 in July to 10 on Jan. 12, before easing to 7.86 since the Feb. 27 market meltdown. "We are encouraged by the increasing evidence that PROMETA can change the paradigm of substance-abuse treatment," says Jack president of Siar Capital, which owns shares.



Ethanol Is Music to Mosaic's Ears

AS CORN PRICES shoot up—to \$4.24 a bushel—because of demand from ethanol makers, fertilizer prices are soaring, too. Corn used for making ethanol in the U.S. has tripled in the past five years, to 2.2 billion bushels, and farmers need more fertilizer than ever to keep up with demand. Little-known Mosaic (MOS) is a pure fertilizer play as it is the world's largest producer of phosphate and third largest of potash, both of which are used as fertilizer. "Farmers are expected to plant 87 million acres of corn this spring, and the challenge is how to increase their yield. That's where Mosaic benefits," says William Harnisch, president of Peconic Partners, which owns 5 million Mosaic shares. The stock has been on a tear, climbing from 13 in June to 25.95 on Mar. 7. The stock will hit 40 in a year, says Harnisch, because of the huge demand for corn that he believes will continue for years. Higher corn prices, he will push farmers to apply more fertilizer to maximize yields. David Silver of JPMorgan Securities rates Mosaic overvalued based on stronger phosphate prices. ■



BusinessWeek .com

ONLINE: Gene Marcial's Inside Wall Street is posted at businessweek.com investor at 5 p.m. EST on the magazine's publication day, usually Thursday. **Note:** Unless otherwise noted, neither the sources cited in Inside Wall Street nor the positions in the stocks under discussion. Similarly, they have no banking or other financial relationships with them.

STOCKS

S&P 500



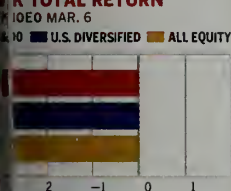
MENTARY

ors still feel jittery. ry Secretary Hank n's soothing words that age defaults wouldn't the economy touched off rebound on Mar. 6. But rket lost ground after a port highlighted sluggish mic activity in parts of the d a warning from builder orton that home sales slow even more.

Bloomberg Financial Markets, Reuters

MUTUAL FUNDS

WEEK TOTAL RETURN



WEEK TOTAL RETURN



ard & Poor's

THE WEEK AHEAD

SALES Tuesday, Mar. 13, 4:30 a.m. EDT » Retail sales are not to have grown 0.4% in March after holding steady in February, according to economists surveyed by Action Economics. Motor vehicles, sales probably rose 0.3% as well, after a 0.3% gain.

DEFICIT ACCOUNT Wednesday, Mar. 14, 4:30 a.m. EDT » The March quarter current account deficit is most likely narrowed

U.S. MARKETS

	MAR. 7	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
S&P 500	1392.0	-1.1	-1.9	9.1
Dow Jones Industrials	12,192.5	-0.6	-2.2	11.0
NASDAQ Composite	2374.6	-1.7	-1.7	4.7
S&P MidCap 400	824.0	-1.7	2.4	7.9
S&P SmallCap 600	397.4	-2.0	-0.6	7.0
DJ Wilshire 5000	14,036.8	-1.2	-1.3	9.4

SECTORS

	MAR. 7	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
BusinessWeek 50*	785.9	-0.6	-1.6	4.3
BW Info Tech 100**	426.0	-2.3	-4.8	10.7
S&P/Citigroup Growth	638.9	-0.9	-2.1	5.9
S&P/Citigroup Value	751.8	-1.2	-1.6	12.4
S&P Energy	439.6	0.6	-3.5	14.0
S&P Financials	475.7	-1.4	-4.0	9.2
S&P REIT	200.6	-4.5	0.9	19.5
S&P Transportation	261.9	-0.9	-0.7	-1.0
S&P Utilities	192.4	-1.2	3.1	20.7
GSTI Internet	197.7	-2.8	-1.0	4.3
PSE Technology	869.7	-1.5	-0.7	1.0

*March 19, 1999=1000 **February 7, 2000=1000

BEST-PERFORMING GROUPS

	LAST MONTH %		LAST 12 MONTHS %
Tires & Rubber	13.4	Tires & Rubber	115.5
Constr. Materials	9.4	Divsfd. Metals & Mining	56.2
Oil & Gas Refining	7.8	Steel	53.1
Power & Energy Traders	7.4	Constr. Materials	51.9
Forest Products	6.2	Power & Energy Traders	37.6

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS			
Japan	0.3	Real Estate	25.3
Utilities	-1.0	Pacific/Asia ex-Japan	25.3
Domestic Hybrid	-1.7	Utilities	24.0
International Hybrid	-1.8	Latin America	23.8
LAGGARDS			
Latin America	-7.0	Health	0.6
Real Estate	-6.3	Technology	2.3
Pacific/Asia ex-Japan	-6.2	Small-cap Growth	4.0
Diversified Emerging Mkts.	-6.1	Japan	4.4

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS			
ProFunds USh. Russell 2000	19.3	Dreyfus Prem. Grtr. China A	54.6
ProFunds USh. Real Estate	18.2	Old Mut. Clay Finlay Ch. A	46.6
ProFunds USh. Financials	11.6	E.I.I. Int. Property Instl	45.5
DireXn. Sm. Cap Bear 2.5X	9.5	Oberweis China Opport.	45.4
LAGGARDS			
ProFunds USh. Real Estate	-16.8	DireXn. Dev. Mkts. Bear 2X	-28.6
iShares DJ U.S. Home Constr.	-15.4	American Heritage Grth.	-25.0
Eaton Vance Greater India A	-14.9	DireXn. Sm. Cap Bear 2.5X	-19.4
Matthews India	-13.3	SPDR S&P Homebuilders ETF	-18.9

GLOBAL MARKETS

	MAR. 7	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
S&P Euro Plus (U.S. Dollar)	1969.9	-1.5	-1.0	23.1
London (FT-SE 100)	6156.5	-0.2	-1.0	5.1
Paris (CAC 40)	5455.1	-1.1	-1.6	9.3
Frankfurt (DAX)	6617.8	-1.5	0.3	15.3
Tokyo (NIKKEI 225)	16,764.6	-4.8	-2.7	6.6
Hong Kong (Hang Seng)	18,918.6	-3.7	-5.2	21.3
Toronto (S&P/TSX Composite)	12,989.6	-0.4	0.6	9.9
Mexico City (IPC)	26,184.4	-1.7	-1.0	41.1

FUNDAMENTALS

	MAR. 6	WEEK AGO	YEAR AGO
S&P 500 Dividend Yield	1.83%	1.83%	1.80%
S&P 500 P/E Ratio (Trailing 12 mos.)	16.9	17.0	17.7
S&P 500 P/E Ratio (Next 12 mos.)*	14.9	14.9	14.9
First Call Earnings Revision*	0.90%	-1.55%	-1.20%

*First Call Corp.

TECHNICAL INDICATORS

	MAR. 6	WEEK AGO	YEAR AGO
S&P 500 200-day average	1345.5	1342.9	Positive
Stocks above 200-day average	67.0%	73.0%	Neutral
Options: Put/call ratio	1.32	1.09	Positive
Insiders: Vickers NYSE Sell/buy ratio	7.36	8.07	Negative

WORST-PERFORMING GROUPS

	LAST MONTH %		LAST 12 MONTHS %
Homebuilding	-14.2	Distillers & Vintners	-22.2
Specialized REIT's	-13.6	Homebuilding	-22.1
Spclzd. Cnsmr. Serv.	-13.5	Electric Mfg. Svcs.	-19.0
Photographic Products	-13.0	Photographic Products	-16.6
Residential REIT's	-12.3	Gold Mining	-14.2

INTEREST RATES

KEY RATES

	MAR. 7	WEEK AGO	YEAR AGO
Money Market Funds	4.86%	4.86%	4.07%
90-Day Treasury Bills	5.09	5.14	4.60
2-Year Treasury Notes	4.53	4.63	4.75
10-Year Treasury Notes	4.49	4.56	4.73
30-Year Treasury Bonds	4.63	4.67	4.71
30-Year Fixed Mortgage †	6.05	6.05	6.10

† BankQuote Inc.

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND	30-YR. BOND
General Obligations	3.72%	4.06%
Taxable Equivalent	5.31	5.80
Insured Revenue Bonds	3.87	4.35
Taxable Equivalent	5.53	6.21

The *BusinessWeek* production index declined to 293.7 for the week ended Feb. 24, but stood 8.6% above the year ago level. Before calculation of the four-week moving average, the index fell to 292.4.

BusinessWeek.com

For the BW50, more investment data, and the components of the production index visit www.businessweek.com/extras

CONSUMER PRICE INDEX Friday, Mar. 16, 8:30 a.m. EDT » February consumer prices are forecast to have risen 0.3%, following a 0.2% gain in January. Less energy and food, the index probably rose 0.2%, after January's 0.3% rise.

INDUSTRIAL PRODUCTION Friday, Mar. 16, 9:15 a.m. EDT » Monthly factory output likely rebounded 0.3%, after a 0.5% drop last month. The utilization rate is expected to have held at 81.2%.

to \$204.3 billion after a third-quarter gap of \$225.6 billion.

EXPORT-IMPORT PRICES Wednesday, Mar. 14, 8:30 a.m. EDT » February import prices probably rebounded 0.7%. Export prices likely grew 0.2%.

PRODUCER PRICE INDEX Thursday, Mar. 15, 8:30 a.m. EDT » Producer prices likely rose 0.4% in February after a 0.6% drop in January. Less food and energy, wholesale prices probably climbed 0.2%.

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This index gives the starting page for a story or feature with a significant reference to a company. Most subsidiaries are indexed under their own names. Companies listed only in tables are not included.

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destepping Disaster

STRATEGY PARADOX Why Committing to Success Leads to Failure (And What to Do About It)

Michael E. Raynor; Currency/Doubleday; 303pp; \$27.50

...which of these three companies
...it's not fit with the other two: Apple,
...the cutting-edge iPod line has
...it a darling of Wall Street; IBM,
...the culture of quickly co-opting
...innovations of others has helped
...over decades of steady returns; or
...while media conglomerate Vivendi

...al, whose failure cost CEO Jean-Marie
...his job and his shareholders billions
...?

...re an investor, you probably consider
...to be the outlier. But according to
...E. Raynor, author of *The Strategy
...Why Committing to Success Leads
...e (and What to Do About It)*, there's
...a fine line between Apple's success
...ndi's woes. Both took bold risks that
...nherently logical at the time, but
...timing with the iPod simply proved
...ter than Vivendi's early bet on the
...—a predicament Raynor calls the
...paradox. "The strategies that have the
...nces of succeeding brilliantly are also
...most exposed to the most debilitating
...strategic uncertainty," writes Raynor, a
...shed fellow at Deloitte Research and
...r with Clayton Christensen of *The
...r's Solution*. "Whatever the industry, firms that guess
...l commit more vigorously to the strategy that fortune
...y favors will defeat their competitors."

...cover what separates companies that excel from
...t fall short, Raynor took a different tack from other
...nent scholars. Instead of merely studying winning
...es, in the mode of Jim Collins' classic *Good to Great*,
...also conducted postmortems of thousands of losers.
...ved a valuable undertaking, providing many of the
...netrating revelations.

...author was surprised to find that successful and
...panies shared so many similarities. (On that
...cludes case studies of winning approaches, such
...of Microsoft and Johnson & Johnson, as well as
...failures such as Vivendi, Canadian telecom giant
...Sony, with its unsuccessful Betamax and MiniDisc
...gies.) Most had made reasonable assumptions
...future of their businesses and had executed their
...relatively well. In an unexpected number of
...what separated the winners from the losers was
...or timing or unforeseeable changes in the landscape

that played into the hands of some companies—and out
of the hands of others. For instance, Raynor makes the
provocative argument that Apple's success with the iPod
was somewhat serendipitous: The popularity of Napster
and other music-download sites created instant demand
for digital-music devices while crushing the market for disc
players like Sony's MiniDisc, which Raynor contends was
a well-conceived product. Similarly, Vivendi's undoing was
that its huge bets on the Internet came too early, and, Raynor
argues, that Messier became too involved in minutiae at the
expense of broader strategy.

To some degree, this all makes business sound like a
crapshoot and explains why many companies
opt for a strategy that minimizes failure but
limits opportunities for explosive growth as
well. But Raynor has created a governance
structure that, he contends, allows leaders to
forgo this traditional trade-off and achieve
high returns even as they minimize the risks
associated with growth. For a company to be
able to adjust to unexpected shifts in business,
he says, many traditional management roles
must be redefined.

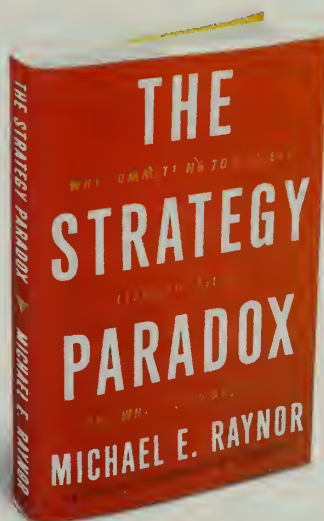
First, boards of directors should not be
involved in strategy, he says. Rather, the role
of a director should simply be to define the
"strategic risk profile" for the company. "It
is legitimately—and perhaps primarily—the
board's role to consider carefully the trade-
offs between risk and return implied by any
strategy that management
might propose," he writes.

Next, Raynor argues, CEOs
should concentrate not on
operations but on developing
long-term strategies—or rather,
a set of long-range strategic
options. Lastly, Raynor favors
creating a team of line managers
who oversee the company's
short-term operations and who
don't worry about strategy.

Making these pieces fit
together requires a plan,

which Raynor provides as well. He suggests that senior-
most executives map out every scenario they can imagine,
as well as a menu of possible responses for each of these
developments. Then, as the future unfolds, they determine
which options are appropriate and take action. Overall,
Raynor's approach requires more strategic planning than
many companies are accustomed to. But if he's right, it could
enable them to avoid becoming yet another statistic. ■

—By Dean Foust



**Raynor
argues for a
governance
structure that
will allow for
safer growth**



Ideas Outside Shot

BY LAURA D'ANDREA TYSON

A Resilient World Economy

Just a few weeks ago, when global equity markets were still soaring, hundreds of business and political leaders made their annual pilgrimage to the World Economic Forum in Davos, Switzerland, to discuss what was in store for 2007. The mood was upbeat and the forecasts rosy. Another “Goldilocks” year of strong global growth with low inflation was the consensus. To be sure, the

economy was slowing as its housing sector swooned, but growth in both Europe and Japan was rebounding, China was continuing to surge ahead at 10% per annum, and India's growth was not far behind.

One reason for optimism: Emerging markets accounted for more than 50% of global output—a milestone achieved in 2006—and the world economy was simply not as dependent on U.S. growth as it had been for most of the previous decade. Reflecting the bullish sentiment, 9 out of 10 CEOs surveyed in Davos predicted a strong 2007 for the global economy. But this forecast was before the large, unexpected losses that have slammed global markets since late February. Was the Davos consensus wrong? Is it time to reassess the outlook for the world economy? I don't think so.

AT THE BEGINNING of 2007, global financial markets were “priced for perfection.” Wall Street was enjoying the longest period without at least a 2% daily fall for more than 50 years. Meanwhile, risk premiums on assets such as corporate debt, especially that of highly leveraged companies, and emerging-market debt were at historic lows. The appetite for risk was fed by long-term interest rates that had reached 25-year lows and by the spectacular growth of credit derivatives. The global money supply was growing at its fastest pace since the 1980s, resulting in both excess liquidity in credit markets and excess complacency. In short, evidence was mounting that financial markets were poised for a correction.

Nowhere were the signs more apparent than in China, where the stock market had soared from historic low to historic high in one year. Millions of new individual investors, both young and old, were rushing to invest in China's illiquid and immature stock market for the first time, using bank loans, credit cards, and retirement savings to buy a piece of the action. A few days after his appearance at Davos, Cheung Siwei, an influential vice-chairman of China's National People's Congress, warned of a bubble in the country's stock market and urged investors to pay

more attention to risk. His comments sparked rumors of government policies to stem market speculation in advance of the party congress' annual March meeting. It seems likely that the rumors played a role in triggering a massive sell-off of shares that caused China's stock market to plunge by nearly 9% on March 15.

The correction in China's overheated market may have been entirely unexpected, but its ability to prompt sudden reductions in the prices of almost every risky asset everywhere else in the world was. Correlations between financial market changes in developed countries have increased significantly in recent years as capital flows between them have soared. But China's stock market remains

and insulated from foreign investors, and there is no evidence investors sold assets in other parts of the world to cover losses there. Nonetheless, Shanghai's plunge unhinged global markets, leading Morgan Stanley economist Stephen Roach to quip that “like nearly everything in the world these days, it now appears that stock market corrections are made in China.”

In fact, China's stock market plunge was a wake-up call for investors globally, prompting a reassessment of risk that has increased credit spreads and returned market volatility to more normal levels. But all of this has happened without any real change in the underlying economic fundamentals, which remain strong. The world economy has indeed slowed but the odds of a

recession are low. Europe is enjoying its strongest growth despite unresolved structural problems. The yen is appreciating in response to Japan's stronger growth, while China and India are growing rapidly—possibly to the point of overheating.

Overall, the rise of the emerging market economies is providing the biggest boost to both global supply and demand since the Industrial Revolution. There are certainly economic risks ahead, but they are not new ones. It's just that investors are now paying more attention to them. ■

Beneath recent tremors, the underlying fundamentals remain strong

Views expressed in Outside Shot are solely those of contributors.

Laura D'Andrea Tyson, a professor of business and economics at the University of California at Berkeley, was chairman of the Council of Economic Advisors in the Clinton Administration.

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Ideas **The Welch Way**

BY JACK AND SUZY WELCH

Choosing China or India

Which country has the best business prospects in the long run—China or India?

—Ravikiran Prabhakara, Bangalore, India

Don't we wish we knew the definitive answer to that question! Doesn't everyone? That's why there are so many books, articles, speeches, research papers, and even blogs on the topic. It seems that everyone not already playing in the global market is trying to figure out which of the two emerging powerhouses to bet on.

Our opinion is neither. Or both. Or either one. What we mean is, the choice between China and India is entirely situational. Both countries have advantages and disadvantages. The only way to pick between them, if you must, is to find the right match for your business. That means figuring out which country is best equipped to help you win. It's as simple as that.

O.K., maybe determining that match isn't so simple. There's tons of information out there, lots of it contradictory, and most big companies have already sorted through it all for their own conclusions. But for a small or midsize company still in the process of considering globalization, we would offer a four-part framework as a way to think through the China-India conundrum. It's based on the assumption that economies have four ingredients that facilitate success: political stability, infrastructure, local and export markets, and the "human grrr factor"—not a technical term, but you know what we mean.

China and India each have some portion of these ingredients. The question is not which has more. It's which has the right amount for you.

»Political Stability. If that's what your business desperately needs (say it must make huge capital investments), India is the better fit. Yes, it's riddled with corruption. But its top team, led by Prime Minister Manmohan Singh, is said to have real integrity.

The downside of India's form of coalition democracy, of course, is a bureaucracy that moves slowly—as in cold molasses. Meanwhile, China was able to clear a province of 1.9 million people and, within 15 years, complete the colossal Three Gorges Dam, which will generate 18,000 megawatts of electricity annually. But regard for China's speed advantage has to be tempered. It is in the midst of a massive experiment,

**Here's a way
to figure
out which,
if either,
is right for
your business**

trying to wed economic freedom and political collectivism. Will the marriage last? Maybe, but in the worst-case scenario its collapse could put foreign investments at risk of outcomes that include confiscation. In other words, the lower your outlay to get started, the more attractive China becomes. **»Infrastructure.** By contrast, if infrastructure is what your business needs to succeed, advantage China. It has 10 times as many express highways, for example, and its power costs 40% less. You wouldn't ever pick, say, Mumbai to build an electricity-devouring aluminum plant to serve global markets. But you wouldn't be off base to plant your global ad agency, movie studio, or call center there.

»Markets. The edge goes to China when it comes to local markets. Its GDP is almost three times that of India, and it has more consumers with buying power. China's industrial buyers also beckon, thanks to the country's manufacturing sector. India has long concentrated on its service sector at the expense of manufacturing. Indeed, India's only local manufacturing advantage could be that it's easier to enter and survive there because, well, it's just so much less competitive than China.

As for exports, it's China again, as the country's manufacturing productivity and process-improvement efforts overwhelm India's. You can go it alone there, form a joint venture, or do contract manufacturing to feed your global supply chain. Only in high-tech manufacturing does India offer an edge to exporters, but probably not for much longer.

»The Grrr Factor. That's the mixture of ambition, energy, and passion that magically fuels economic growth. Every business wants as many people with grrr as they can get their hands on. So which country has more? It's a split decision. China excels at process creativity, India at innovation. But for general, you can't discount the sheer ferocity of the Chinese. Obviously, we are talking broadly, and exceptions abound. But our experience is that because more Chinese people are willing to work at such insane intensity, their productivity is difficult to beat.

Still, what good is grrr if the country with more of it implodes?

Which brings us back to where we started. Look, your question is not an either-or. It's a what-who. What do you need to win, and who can give it to us? Our framework answers those questions beyond a reasonable doubt, but it starts you on the road to globalization. And after that, your only question may be: Why didn't we start sooner? ■

Jack and Suzy Welch look forward to answering your questions about business, company, or career challenges. Please e-mail at thewelchway@businessweek.com. For their weekly podcast go to www.businessweek.com/search/podcasting.htm.

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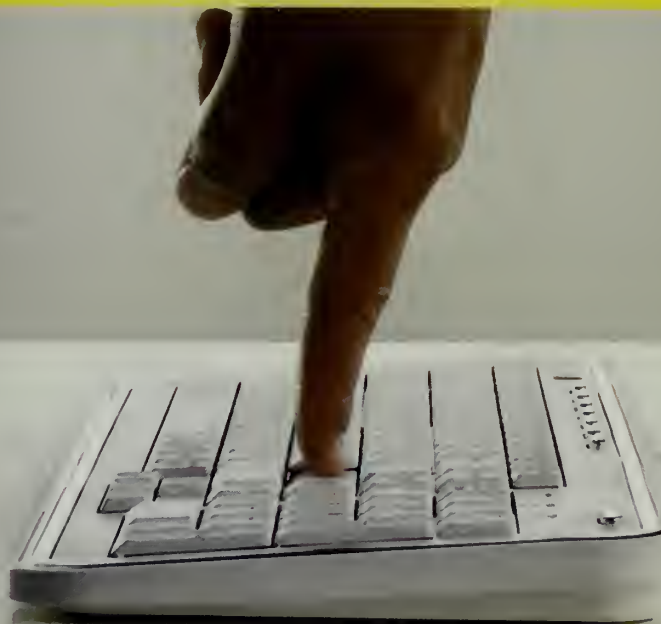
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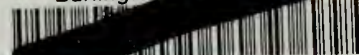
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Putting Accenture's research to work.

Thomas Cook

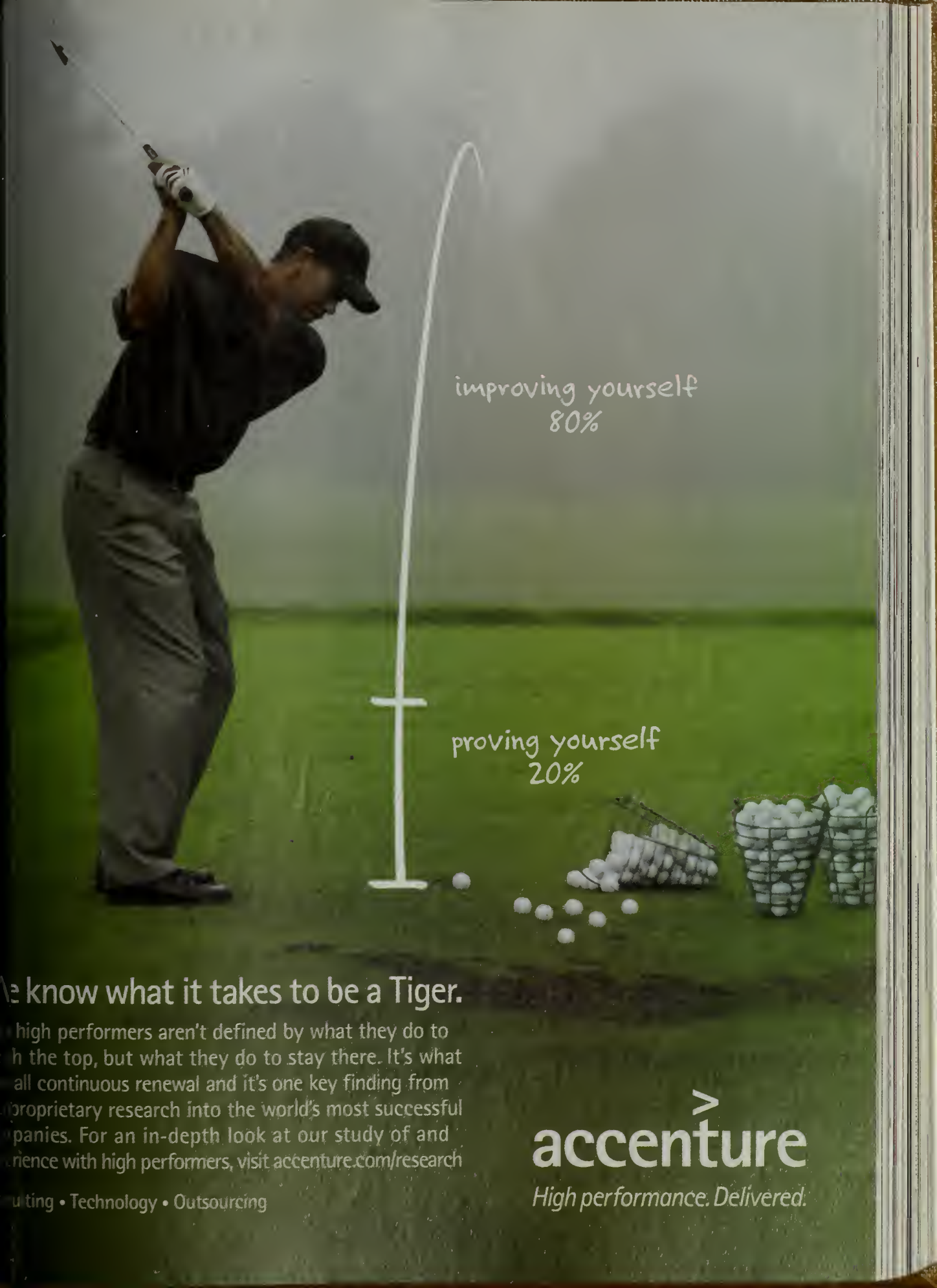
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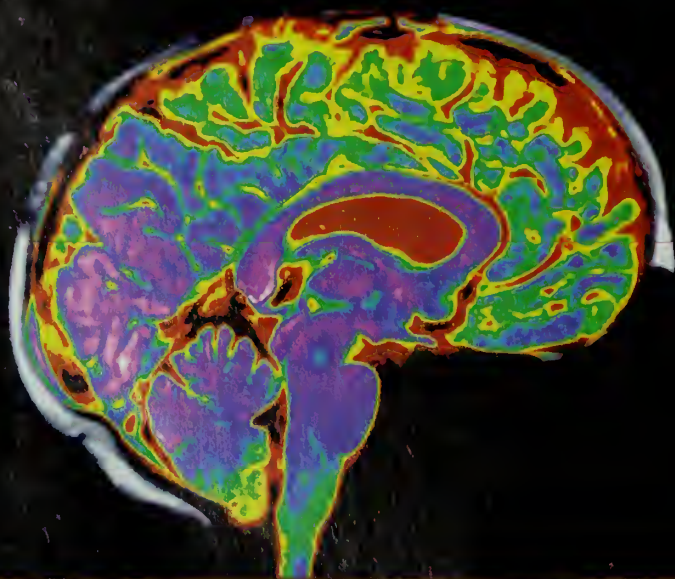
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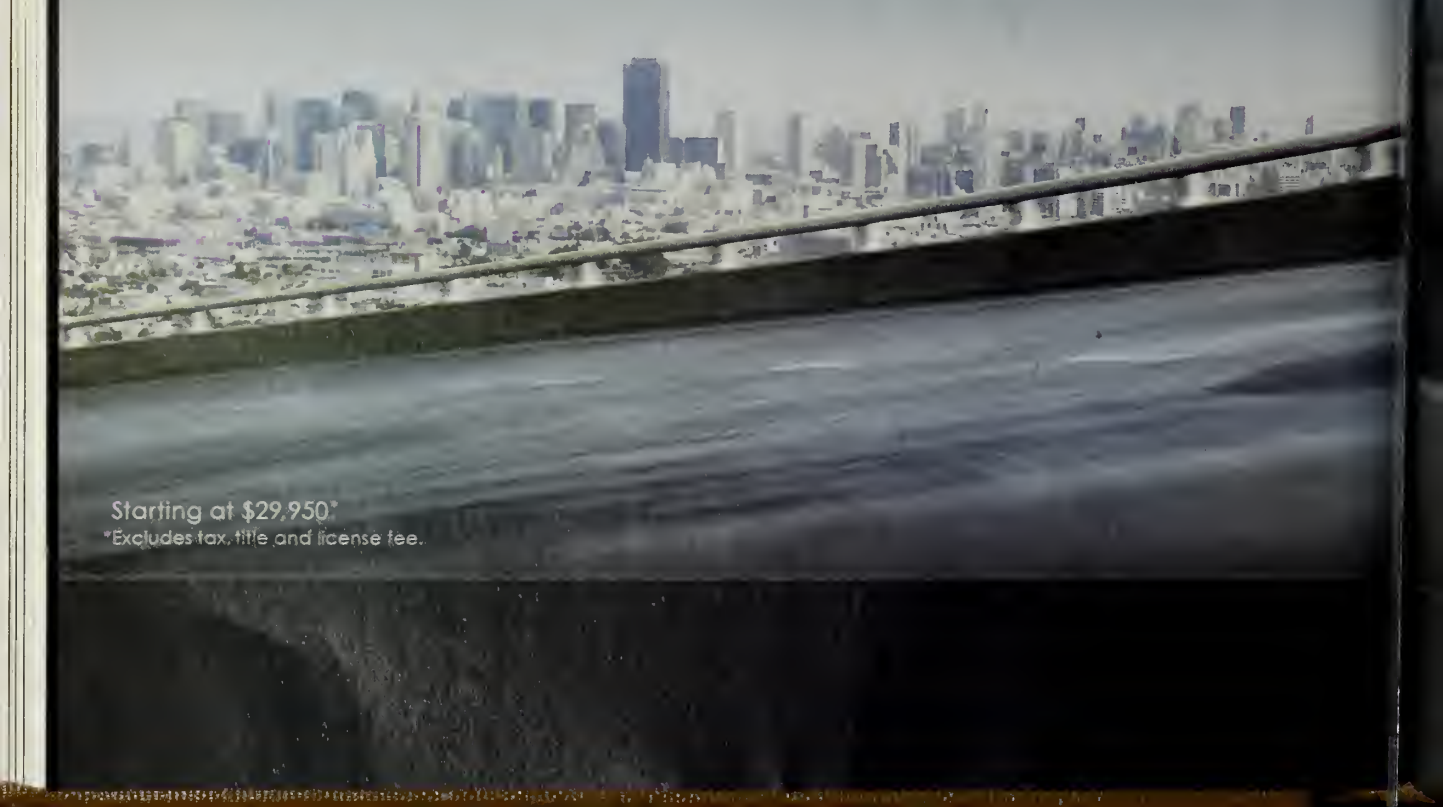
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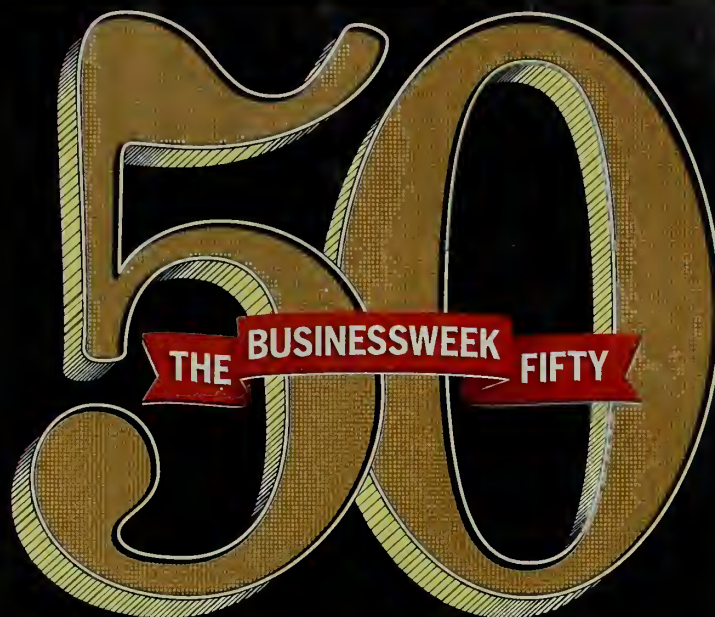
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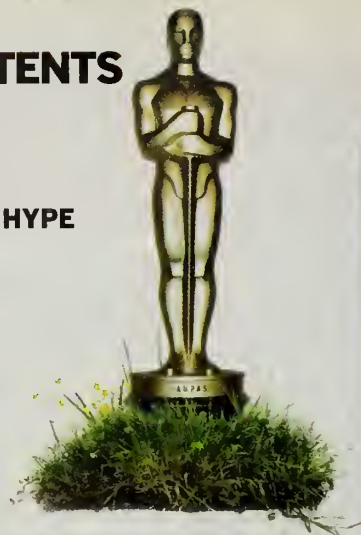
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BusinessWeek (ISSN 0007-7135) Issue number 4027, published
 except for one week in January, July and August, by The
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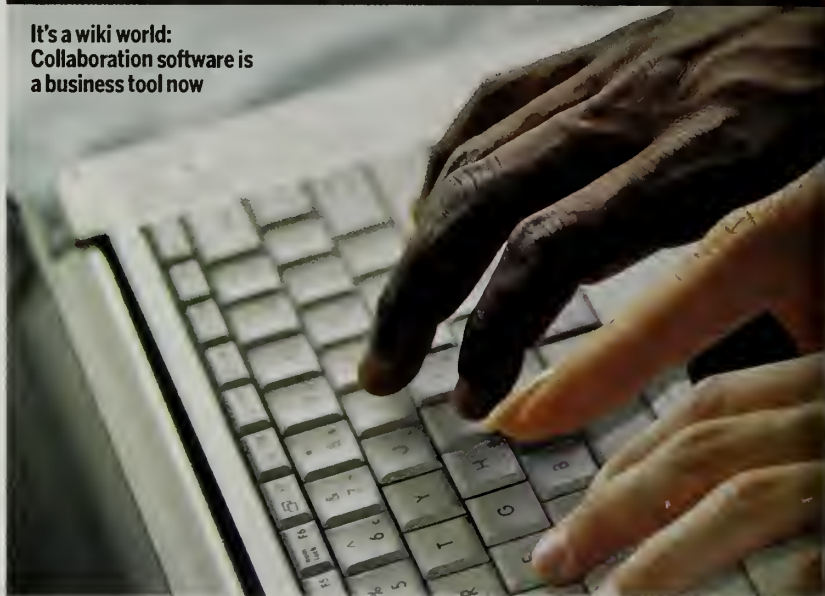
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New Tools for Teamwork

If the word "wiki" makes you think of Wikipedia, you are not alone. The technology that turned the online encyclopedia into an active document—software that lets anyone contribute and edit information on a Web site—is taking root as **a collaboration** in corporations ranging from Intel to Walt Disney to investment bank Dresdner Kleinwort. In a BusinessWeek.com Special Report we look at how the use of this digital tool can quickly spread from a few people to thousands of employees and foster **new** **of teamwork**. In a podcast, Harvard Business School professor Andrew McAfee discusses how companies are grappling with the technology and the ways it affects corporate culture. Big media outfits such as Meredith, American Express Publishing, ABC, and CBS also are turning to collaboration software to help them build communities of interest on everything from scrapbooks to the TV show *Lost*. Finally, if you're ready to get started, be sure to read our tip sheet on **how to contribute content** gracefully to your corporate wiki without stepping on your colleagues' toes. Go to www.businessweek.com/technology/ceo_g for all this and more.

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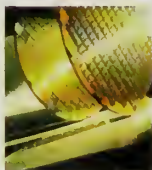
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"We're kind of back in panic mode."

—RBS Greenwich Capital chief economist Stephen Stanley on the stock market's latest slide, caused by subprime mortgage woes and weak economic data, as reported by The Wall Street Journal.

BY DEBORAH STEAD

ENT SPENDING

Collecting on an Old Phone Bill

VOIP WEB-BASED phone service led, so did the industry's as a hotbed of innovation that pulled one over on the phone. But after a Mar. 8 federal court that Web phone pioneer **Vonage** ed on key **Verizon** patents, it's at Net calling owes a debt to well-established technologies.

And patent owners are lining up to collect.

Anthony Cataldo, CEO of **VoIP Inc.**, has already hired lawyers to demand payments from outfits using his company's Web calling patents, one he says, covers a way to place clicking a name in an e-mail, ed, or social networking site. "We're going to see a lot of demand coming out from us," Cataldo says. "There's a deep vein left to mine."

The U.S. Patent & Trademark Office says 2,273 are registered for Voice over Internet Protocol (VoIP) or related technologies. Many belong to players like **Verizon**, **AT&T**, **Motorola**, **Broadcom**, and **Cisco Systems**. Verizon's patents apply to older technologies such as call waiting and security. Others claim to cover how traditional phone and IP networks talk to each other or a method behind enabling wireless Web calls.

Until the Verizon case, most Web-calling patent lawsuits were quietly settled or elicited small awards. But with 9.5 million Americans using services that allow calls over the Web—double the number a year ago—serious money is at stake. The eight-member jury that considered the case against



Vonage in the U.S. District Court for the Eastern District of Virginia awarded Verizon \$58 million in damages and a per-user licensing fee. (Vonage, which plans to appeal, declined comment.)

"Before, this was about running around, thumbing your nose at big bad phone companies," says David McClure, CEO of the U.S. Internet Industry Assn. Now, he says, Web-phone companies "are facing reality."

—Olga Kharif

TR LIVES

FIVE CASE'S WPE AT IDIT CARDS

ONLINE co-founder the Case is out to and another "old" nes model. Case's tnture: using net to try to onize the credit-business. as new payment en **GratisCard**, t tower the

credit- and debit-card fees paid by merchants (\$48.6 billion in 2005). It plans to charge retailers 0.5% of the cost of a purchase—vs. 2.2% per sale, on average, for **Visa** and **MasterCard** credit cards. (GratisCard uses proprietary software to route payments

over the Internet free of charge.)

Scheduled for a formal launch in April, **GratisCard** is negotiating with **Amazon.com**, among other big outfits, in the hopes that such



CASE

Revolution, the private holding company Case started in 2005 with \$500 million of his AOL fortune, is the largest shareholder in **GratisCard**, which is based in St. Petersburg,

Fla. Case is packing his new venture with heavyweights: Former Treasury Secretary Lawrence Summers sits on its board, and the CEO is Jason Hogg, formerly at credit-card giant **MBNA**, now owned by **Bank of America**.

—Brian Grow

BENDING THE RULES



companies will accept the card, according to a source familiar with the matter. Amazon did not respond to requests for comment.

CASINO SOCIETY

BETTING THE SPREAD ON BIRD FLU

Can a virtual betting parlor predict pestilence? A new Avian Flu Market aims to find out. Started on Mar. 1 to predict the chances of a bird flu pandemic, it's being run by the University of Iowa with funding from the Robert Wood Johnson Foundation.

The market gives a select group of international public health and pandemic experts \$100 each in virtual money. The idea is to wager on if, when, and how bird flu will



spread, with participants betting on specifics: when it might arrive in North and South America, for instance.

So far, the H5N1 strain of avian influenza virus has killed 154 humans, all of whom contracted the illness from close contact with fowl. But infectious disease experts believe that over time the virus is likely to mutate and become highly contagious among people, leading to a pandemic that could rival the 1918 influenza outbreak.

The university has had success in predicting seasonal flu outbreaks using a similar market. Its Avian Flu Market is scheduled to run for three years. —Catherine Arnst



SHANGHAI
A government crackdown on too many

CHINA DIARY

WE SAID JUST ONE, WE MEANT JUST ONE

BEIJING IS cracking down on wealthy families flouting its one-child policy. In force for almost three decades, the rule helped limit the country's population to 1.3 billion as of January, 2005. But it has become irrelevant to China's rich and famous, who can afford fines of up to three times or more the average yearly urban income to have an extra child or two.

Now the government's **National Population & Family Planning Commission** says it will hit wealthy offenders with bigger fines—no word yet on how big—and set up a “bad credit” list

to bar scofflaws from receiving honors. Such prizes count a lot to celebrities such as sin and movie stars, who build careers on the “They will have to pay a dear price if they violate the family planning policy,” said Xuejun, director of the commission's Policy & Laws Dept., the English-language *China Daily* reported in early March.

The policy has been loosened in poor rural areas, where some farmers get exemptions. But, perhaps responding to many Chinese who feel it's unfair for the privileged to shrug off the regulation, the commission wants to persuade China's rich urbanites and celebrities to stop after child. Now, “10% of them even have threatened to complain to the press.” —Dexter R

GATEKEEPING

THE PASSWORD IS ‘EXPENSIVE’

IT TYPICALLY costs a company \$10 to \$13 to reset an employee password, according to **Forrester Research**—adding up, in some cases, to millions in annual expenditures as passwords get more complex. “It's always been a problem, but it's gotten a lot worse,” says Jonathan Penn, the Cambridge (Mass.) firm's research director.

Now, Penn says, companies are trying to cut down on resets. One solution: a computer tool that allows an employee

to use just one password to get access to e-mail, intranet, and other accounts. New York-based **Passlogix** has supplied such a system to companies like **Kaiser Permanente** and **IBM**, selling licenses for 6 million users



last year, up from 2 million in 2005.

For those who can't remember even one password, the remedy to create a Web site where employees answer a security question and reset on their own. Combining such automation resets with Passlogix system, the U.S. Postal Service—with more than 300,000 computer-using employees—now spends less than \$1 million annually on resets. Before it began to battle the problem in 2003, it spent more than \$3 million a year—with the number of computer users. “We needed a range of solutions to make it better,” says Rick Wei, an IT program manager at the agency. —Sony



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UP Front



WEB SPORTS

A LIVELY FANTASY LIFE FOR ESPN

WITH OPENING DAY for Major League Baseball near, many of the 16 million stat heads who play fantasy games are lining up their teams. Sports network ESPN aims to stack its own lineup.

It has been snapping up fantasy sites, hiring big-name writers, and offering its online games free to grab share from rivals, including CBS SportsLine.com and Yahoo!, which, with ESPN, make up fantasy gaming's Big Three. "Our goal is to be the unquestioned No. 1," says John Kosner, ESPN's senior VP and general manager of its new media unit.

So far, participation in ESPN fantasy football has risen eightfold over two years, and gamers playing the baseball version have tripled this year. The goal is to lure users with freebies—ESPN used to charge \$30 a team—then sell them ESPN Insider fantasy expert advice and use the bigger audience to raise online ad revenue.

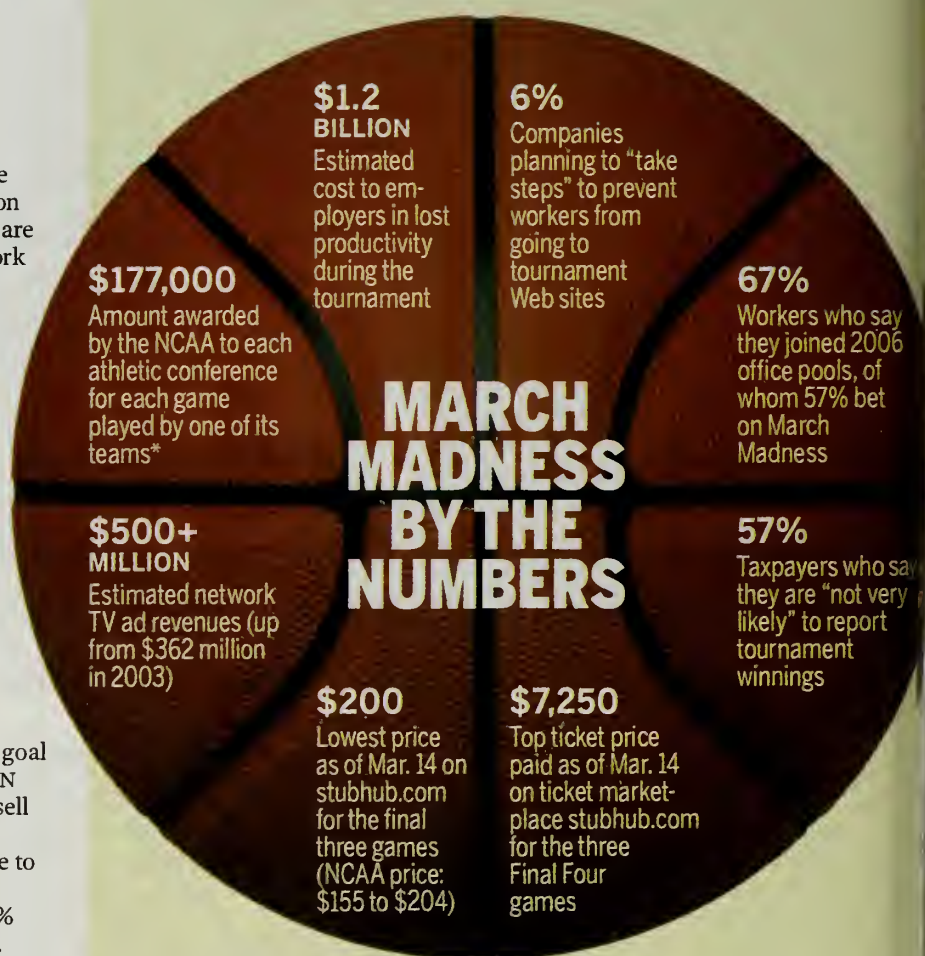
The fantasy world, growing 10% a year, attracts a hot demographic. Players are generally 19 to 49 years old, earn an average \$77,000 yearly, and spend up to five hours a week online running their teams. And 80% buy beer, says the Fantasy Sports Trade Assn. ESPN isn't alone in chasing fantasy's fortunes: Last year, newspaper chain American City Business Journals acquired the Sporting News, a big player. NBC, too, is scouting for sites. Sounds like an aggressive free-agent market.

—David Welch

NOTHIN' BUT NET

More than 100 million Americans, including the estimated 23 million hoop fans with Internet access at work, are expected to follow this year's NCAA men's basketball tournament—tuning or clicking into the games (or just checking scores) starting on Mar. 13. Sixty-five teams, 11 days of play. As the watercooler talk turns to who's up and who's down in the office pool, here are a few off-the-court stats.

—Lindsey Gerdes



*Up to five games

Data: Lost productivity and company contingency plans, Challenger, Gray & Christmas; workers in betting pools, Vault; reporting winnings to IRS, H&R Block survey; StubHub ticket prices, stubhub.com; NCAA prices, NCAA; network TV ad revenues, TNS Media Intelligence; March Madness Advertising Trends Report; payments to conferences, NCAA

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ANALYZE THIS

BY KERRY SULKOWICZ, M.D.

The New Me Nobody Knows

In part because of my husband's work relocation, I'm entering a new industry. I'm bringing the same skills (in marketing) that made me a success in my previous 10-year career, but I'm having a hard time landing a job and I can't seem to stop worrying. I'm up half the night, thinking that I won't stack up against the competition—or that when I do get a job I won't be successful. The list of anxieties grows as my confidence falters. How can I get control over feeling that I have no control? How can I cope with the uncertainty that comes with embarking on a new career path?

Anonymous, New York

I'M NOT CONVINCED that it's simply the new career path that's keeping you up at night, stressful as that challenge can be. There may be more going on deeper down, and I'd like to help you address both levels.

Your first task is to turn your marketing skills on yourself when thinking about applying your talents to the new industry. Remember that marketers who have been successful (like you) can typically promote just about anything. They just have to get up to speed about their products and their customers.

You're not starting from scratch, in other

words. In fact, you'll undoubtedly bring valuable perspectives from your previous career into whatever new field you choose.

To be sure, it's normal for your self-esteem to take a hit as you try to break into a new area: You're accustomed to success, after all, not to uncertainty or rejection. It will pay to remind yourself that you can't be a success right away (so don't demand that of yourself) and that this period of relative demotion won't last forever.

AT THE SAME TIME, you might want to consider whether your feelings of loss of control also stem from the degree to which your professional fate depends on your husband's work assignments. This can cause understandable anger—a resentment you may be struggling to suppress, perhaps because your mate had no control over the move he had to make. It's precisely this



internal conflict that makes you tend to disavow your feelings. And when such emotions go underground, they can reappear in the form of severe anxiety or other behavioral symptoms. Find ways to express your feelings about the move without making your husband feel

guilty about the relocation. Getting that on the table may provide just the relief you need as you dive headfirst into your job search.

If you approach your worries as nothing more than a career transition problem, you miss these underlying issues. And chances are, that will only intensify your anxiety, making an already challenging transition more difficult.

Kerry J. Sulkowicz, M.D., a psychoanalyst and founder of the Boswell Group, advises executives on psychological aspects of business. Send questions at analyzethis@businessweek.com.

QUESTION OF THE WEEK

What's the most interesting thing you learned this year at TED, the annual invitation-only Technology, Entertainment, and Design meeting held in Monterey, Calif.?

"I was surprised that it was such a consistent environment of inspiration to act and live green. I didn't think that was going to be so much a part of this conference."

—Katrina Markoff, founder, Vosges Haut-Chocolat



"I loved Paul Ewald's talk about evolving pathogens in an intentional way—the idea you can help a disease evolve to be less virulent."

—Tim Brown, CEO, design firm IDEO



"Sometimes spectacle can take away from substance. [Swedish global health professor] Hans Rosling swallowed a sword. Everyone forgot what he said before that."

—John Maeda, author, *The Law of Simplicity*; associate design professor, MIT Media Lab



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Wind Velocity [V , m/sec]

Air Temp

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Air Density

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Wind Velocity
10 m/sec

Wind Velocity
10 m/sec



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“JetBlue has deftly turned its ‘extraordinary stumble’ into an exemplary lesson in customer relations.”

—Christopher Kercher
New York

JETBLUE CUSTOMERS STAND BY THEIR CARRIER

IF YOU HAD ASKED for my opinion on JetBlue Airways' customer service in the early hours of Feb. 15, when I'd finally left New York's John F. Kennedy International Airport after hours of waiting for a flight that was then abruptly canceled, I would have agreed that the airline is toast. However, JetBlue's response since then is worthy of a B-school case study, like Johnson & Johnson and the famous Tylenol recall ("Customer service champs," Cover Story, Mar. 5).

Not only did the airline move quickly to apologize, accept full responsibility, and proactively introduce a passenger's bill of rights (all effectively communicated by e-mail from CEO David Neeleman) but they actually had someone call me to apologize. When I wasn't available, they even e-mailed me to find out when would be the best time to speak with me.

When they reached me, the caller was not some outsourced telemarketer working from a script. Instead, she actually asked me for my opinion of what went wrong and how they could fix it. She engaged me in a dialogue about the steps the airline was considering and sought

my opinion on whether the measure would be enough. She thanked me for my help and patience and asked me to give the airline a second chance. They got it.

Many companies, when faced with such a consumer crisis, first deny the problem, then promise to study the issue, then "resolve" it with some personnel changes. In stark contrast, JetBlue moved swiftly to own up to its failures, honestly explain why they happened (too much expansion without sufficient infrastructure), and worked to both fix the problem and mend fences with customers who were harmed. By bringing customers into the process by actively seeking our opinions and feedback, JetBlue has deftly turned its "extraordinary stumble" into an exemplary lesson in customer relations.

By the time *BusinessWeek* went to press, JetBlue had launched itself back to the top of my list.

—Christopher Kercher
New York

YOU STATE THAT JetBlue had piled up service accolades faster than most airlines rake up complaints, which contributed to its passengers' high expecta-

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BusinessWeek
 MARCH 26, 2007 (ISSN 0007-7135) *** 4027

Published weekly, except for one week in January, July and August by The McGraw-Hill Companies. Inc. **FOUNDER:** James H. McGraw (1860-1948).
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ReadersReport

tions. Some writers in the field, and one mentioned in your article, seem to feel that JetBlue may have a difficult time regaining trust since those high expectations were shattered during the recent meltdown. I disagree.

Research I conducted on airline customer loyalty as part of my doctoral studies at Case Western Reserve University in 2001 (after the major carriers' meltdown during the summer travel season of 2000) found that the airlines had created a climate of low expectations, which led to "passive submission and unresisting acceptance of what is imposed," or a mode of satisfaction referred to as "satisfaction as resignation."

The research would indicate that JetBlue's implementation of a number of system and policy changes to support CEO Neeleman's "service guarantee" will bring back passengers who were inconvenienced but resigned to the fact that this sort of thing happens occasionally. JetBlue's systematic service-recovery process will result in its passengers continuing in the future to receive the service they expect. Therefore, they will forgive JetBlue for an occasional lapse.

Southwest Airlines and JetBlue understand this. Too bad the other carriers haven't figured it out.

—Leonard Lane
Paul Merage School of Business
University of California
Irvine, Calif.

IN THIS TIME of corporate greed and scandalous white-collar crimes, company managers often hide behind press releases and spokespersons. I applaud the manner in which JetBlue handled the situation.

As CEO, David Neeleman could easily have hidden or made excuses for the airline's delays and cancellations. Instead, he was front and center in admitting his mistakes, apologizing, and detailing plans to help ensure that those mistakes do not happen again. His business ethics and sincere passion for customer service are the backbone of what the company is all about.

Unfortunately, in our society we flock toward the negative. Even in bad times, JetBlue was able to show the corporate world how things should be done.

—Lawrence Ciambriello
Trumbull, Conn.

EXCISING JETBLUE from *BusinessWeek's* first-ever ranking of customer service champs showed poor judgment and casts doubt on the criteria used to arrive at

the rankings. This omission was treated with self-serving theatrics by featuring the graffiti-like reprimand on the cover. It was out of balance with the airline's fine reputation.

I am one of the millions of travelers who know that JetBlue has a nonpareil record of concern for the public. No other airline, and few U.S. corporations, can match JetBlue for superb customer service. While it's true that the airline could have been better prepared for this emergency, it was a singular instance that cannot speak for the airline's extraordinary great care, day in and day out, for its passengers.

On September 11, 2001, JetBlue was among the first responders to aid passengers stranded at JFK by other airlines as well as JetBlue. It provided information, emergency money, and long-distance ground transportation. JetBlue has been quick to respond in many emergencies and David Neeleman was extraordinary in his candor and apology. These are the same traits that will put JetBlue right back on your list of top customer service companies in short order. Shame on you, *BusinessWeek*, for your rash and brazen scolding of this fine corporation.

—Ronald D. Scott
Long Beach, Calif.

SERVICE KUDOS FOR UPS? ARE YOU KIDDING?

I WAS APPALLED that United Parcel Service was rated eighth in your customer service ranking.

UPS is the worst at delivering packages to your home. It does not consider the recipient to be its customer. Rather, UPS considers the sender to be its customer, ostensibly through a long-term delivery agreement between UPS and said merchant.

How do I know this? I've placed several calls to the UPS customer support center to complain about delivery delays, packages being crushed by UPS vehicles (with the tire tracks to prove it) to packages left uncovered in the rain, to botched delivery dates.

Has UPS made any attempt to correct these situations? Not to date. Why? The answer is short and sweet: "You are not our customer."

UPS may have all the latest whiz-bang navigation software your article depicted but don't mistake software capabilities for customer focus. For all my delivery needs, I'll stick with No. 24 on your list, FedEx.

—Dan McMenamin
Ellington, Conn.

SAA MAY BE EVEN BETTER THAN WE THOUGHT

HAVE BEEN a customer of USAA since 1962, when I was a brand new lieutenant and had no concept of what made an outstanding insurance company. This has been my only insurance company since, and I would never consider switching.

As good as you made USAA's customer service sound, I think it's even better. The representatives are polite, knowledgeable, and extremely responsive. And if a customer has a valid claim, USAA is there to help, not impede. There is a strong bond of trust between the company and its customers, which is quite rare.

It certainly has a lot to do with the integrity of the client base, which is current and ex-military personnel and their families. But it also reflects on a management that is strongly motivated to serve that client base and whose interests are above and beyond pure financial reward for themselves. You nailed this one.

—Todd L. Bergman
Honolulu

MAGNETAR CAPITAL SAYS ITS SUBPRIME STRATEGY IS SPOT ON

WHO WILL GET SHREDDERED?" (News & Insights, Mar. 19) expresses an erroneous view about Magnetar Capital and the impact of its exposure to the subprime mortgage market. We are a multi-strategy fund. Our investment strategy in mortgages is fully hedged and set up for volatility. We anticipated the current volatility, and in fact today's environment is very favorable to our strategy. In short, our timing has been great. This strategy has enjoyed strong positive returns to date, and we are well-positioned going forward.

—Alec Litowitz
CEO, Magnetar Capital
Evanston, Ill.

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PROGRAM FOR LEADERSHIP DEVELOPMENT

JULY 2007

DECEMBER 2007



Vista: Slow and Dangerous

When I write a column, I almost never feel I have had enough time using the product under review. Even in the rare instance in which deadlines aren't bearing down, I often realize later on that I've missed a fair amount. In the case of Microsoft's Windows Vista, flaws that I thought would grow less annoying with extended use have actually become more troublesome.

Most of the time I spent testing Vista was with sluggish pre-release versions. I expected things to improve when I ran the finished software on PCs configured for the new Windows version. I now realize that Vista really is slow unless you throw a lot of hardware at it. Microsoft claims it will run with 512 megabytes of memory. I had recommended a minimum of a gigabyte, but 2 GB is more like it if you want snappy performance. This is especially true if you're also running resource-hungry Microsoft Office 2007.

The most exasperating thing about Vista, though, is the security feature called User Account Control. UAC, satirized in an Apple ad as a security guy who constantly interrupts a conversation, appears as a pop-up asking permission before Windows will do a number of things: change system settings, install programs, or update antivirus software. UAC may well be necessary to block malicious programs from secretly installing themselves or hijacking your browser settings. But Microsoft has designed it to drive you nuts.

A RECENT EXPERIENCE DEMONSTRATES what I mean. I was working away when Windows OneCare, Microsoft's extra-cost security program, suddenly popped open a window asking me if it should give a program called *wercon.exe* access to the network. To begin with, this is a question that would mystify nearly everyone. (It turns out *wercon.exe* is a tool that sends error reports back to Microsoft.) When I clicked O.K., UAC asked me if it should let OneCare proceed. You would think Windows would be able to figure this out for itself and that these different security components would work together. But Vista leaves it all to the user to sort out.

There's a real danger here: UAC is such a nag that many folks will just turn it off, which Microsoft has made quite easy to do. Disabling UAC is especially tempting if you have set up limited accounts for your children that let you restrict the sort of Web sites they can visit, the programs they can run, and the amount of time they can spend on the computer. With



The security program is so annoying you're likely to turn it off

limited accounts, the kids will have to find a parent whenever UAC window pops up. But if you give them unlimited accounts to deal with UAC requests, they can undo any restrictions.

Unfortunately, turning off UAC severely weakens Vista's defenses. In a study of Vista security, Symantec researcher Orlando Padilla found that without UAC, Vista's resistance to hostile software was similar to that of Windows XP. Before Vista, Windows promiscuously let programs install new software and make system changes without any notice to the user. UAC goes way too far the other way, requiring intervention for many innocent actions. The version of UAC in Mac OS X works much better, rarely popping up except during a software installation or upgrade.

As for general usability, I still have trouble finding once-familiar features that have been hidden in odd places. For example, unlike XP's My Network button, an item on Vista's main menu called Network does not give access to any network settings.

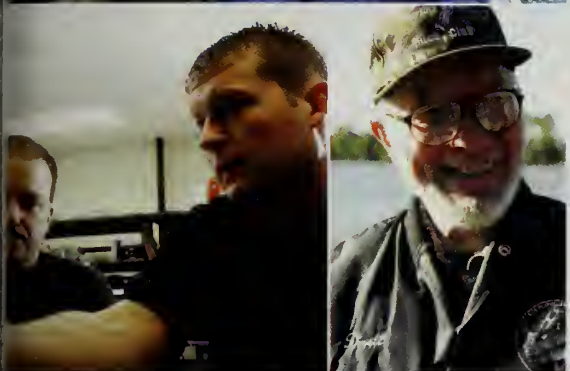
Things don't have to be this way. I've spent as much time with the redesigned Office 2007, and it feels quite comfortable. I'm sure I'll get used to Vista's quirks, Microsoft will smooth out the rough edges, and, in time, Vista's many attractions will outweigh the drawbacks. For now, though, it's a pain. ■

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BY JAMES C. COOPER

Consumers Are Bloodied But Unbowed

Strong job markets, especially in services, will trump the subprime mess

U.S. ECONOMY

Over the past couple of years, consumers have faced one trial after another, from soaring gas prices to the slumping housing market. Now come new worries over subprime mortgages, a jittery stock market, and growing fears that the overall economy may be at risk. Will 2007 be the year that consumers finally stop spending?

Don't count on it. Through all the hardships, strong labor markets have always ridden to the rescue, and this year is unlikely to be any different.

The economy's slowdown in recent quarters has been confined almost exclusively to housing and manufacturing. What's gone largely unnoticed amid the glaring headlines about the housing recession and the downbeat factory data is the continued strength in the broad services sector. That's the area of the economy that has been generating plenty of jobs and income (chart).

Service-producing industries represent 58% of the value of all final goods and services made in the U.S., and they account for 81% of all private-sector payrolls. Economic growth in the sector, measured by its part of real gross domestic product, was actually accelerating last year, with growth of 2.4% in the first half, 2.8% in the third quarter, and 3.8% in the fourth quarter, the fastest quarterly pace in almost three years.

Clearly, there are new risks in the outlook: Market jitters have made businesses a little more cautious, and the extent of the credit-market impact from the subprime mortgage debacle remains unknown. Some homeowners will suffer as credit gets tighter, but the steady gains in jobs and incomes will help to mitigate any broader impact on overall consumer buying. Tight credit rarely becomes a problem for the household sector as long as the labor markets are strong.

To date, service-sector companies show little hesitancy in adding new workers. Recent payroll gains suggest most businesses remain committed to expanding their operations, which is providing a key support for household spending. And new figures on household net worth show consumers still have a steady stream of wealth gains adding support to their financial condition.

THROUGH FEBRUARY, the job markets showed few if any signs of broad stress. Factory weakness is partly related to the housing slump, as business inventories have built up faster than desired, forcing cuts in orders and production. As in previous months, job losses in construction and manufacturing held down the overall increase in payrolls last month. Severe weather

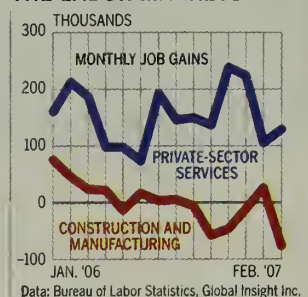
during the Labor Dept.'s survey week, always the week containing the 12th of the month, was also a depressant.

Payrolls increased by 97,000 workers in February, but that reflected a 168,000 gain in service-sector payrolls, vs. declines of 62,000 in construction and 14,000 in manufacturing. Health care, professional and technical services, entertainment, and food services were big gainers. In addition, the Labor Dept. continued its long-running pattern of revising past monthly gains upward. This time it added a net 55,000 more jobs to payrolls in both December and January, most of which were in service categories. Given the recent trend, the February increase could be revised higher as well.

There was even some good news from manufacturers in February. Although factory jobs fell, the pattern of hours worked, including a rise in overtime, suggests

manufacturing production rebounded last month. That bounce, likely to be confirmed by upcoming data on industrial production, would be consistent with results from other recent surveys of industrial activity. Firms appear to be making progress in bringing their inventories into better alignment with demand.

THE POWER BEHIND THE LABOR MARKETS



Business stockpiles rose only 0.2% in January, continuing the slowdown from the rapid monthly increases last year.

WEATHER WAS A BIG FACTOR in both hiring and consumer buying last month. February retail sales barely rose from January, but many stores noted how harsh winter weather had restricted buying. Consumers did a lot of shopping from the shelter of their own homes. Nonstore sales, including catalog and Internet purchases, jumped 2.8% in February, after average monthly gains of only 0.5% during the previous year. Overall February sales were still at a high enough level to suggest real

consumer spending in the first quarter will grow about 3%, a healthy pace by any standard.

The Labor Dept.'s tally of people who said they were not at work last month due to bad weather spiked to the highest reading since the blizzard of January, 1996, and the number was more than twice that recorded in February, 2005. Some of the drop in construction jobs reflected genuine housing weakness, but payrolls also fell sharply in areas where growth is strong, such as business construction and heavy engineering projects.

Even with the two big drags from manufacturing and construction, overall payrolls have posted average monthly gains of 162,000 during the past six months, a bit below the 171,000 per month over the previous six months. But look at service-sector jobs. During the same two periods, the gains there have accelerated, totaling 188,000 per month, up from 157,000.

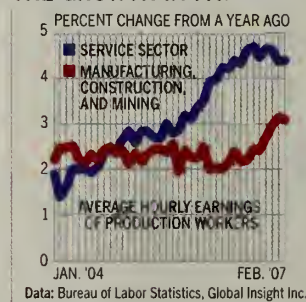
SERVICE-SECTOR STRENGTH is why the jobless rate keeps falling. It hit 4.5% in February, and the recent pace of job growth, if continued, is fast enough to keep the jobless rate heading lower. Plus, consider that joblessness in construction has risen by almost two percentage points over the past year, to 10.5% in February. Outside of construction, the labor markets are even tighter than the overall 4.5% unemployment rate suggests.

The continued tightening in most sectors of the job market is adding to upward pressure on wage growth and helping to generate solid gains in workers' income that are more than double the inflation rate. Overall hourly pay of production workers in February rose 4.1%

from a year ago, up from 3.1% in 2005 and 2.6% in 2004 and service-sector pay is leading the speedup (chart). Also, the government says big accrued pay gains in the fourth quarter in the form of bonuses and stock options will add a boost to personal income in the first quarter.

In addition to healthy income gains, overall household balance sheets are also in excellent condition. Household net worth—assets minus liabilities—rose to a record \$55.6 billion in the fourth quarter. As a percentage of aftertax income, it stood at the highest level in more than six years. Homeowners' equity increased slightly, but the bulk of the rise reflected gains in the

SERVICES ARE LEADING THE GROWTH IN PAY



stock market. In the first quarter, the market sell-off will cap the quarter's increase in stock-related wealth, but it has not been large enough to create a significant drag. Moreover, wealth gains tend to support consumer spending with a lag, so last year's big gains will continue to boost this year's outlays.

Throughout this business cycle, consumers have shown surprising resilience time and again. However, given tight job markets, solid income gains, and healthy balance sheets, a continuation of that staying power in 2007 should come as no surprise at all. ■

WORLD GROWTH

Bringing Inventories Back into Line

THE CLAMPDOWN on inventories isn't just a U.S. phenomenon. Manufacturers across much of the industrialized world are scaling back on production and paring down excess inventories, and that's putting a kink in global growth.

Manufacturers were caught off guard in 2006. Higher energy prices, a pullback in business investment, and the rapidly deteriorating housing and auto sectors in the U.S. led to slowing world demand, while production kept growing at a solid clip. But businesses are responding swiftly. Global factory output in the first quarter is on pace to grow at an annualized rate of only 1.8%, after

slowing to 3.1% last quarter, from growth averaging 5.5% in the second and third quarters of 2006, according to JPMorgan Chase.

The adjustment is currently at varying stages across the globe. There seems to have been little to no inventory upswing in the euro zone; levels there are reported to be lean.

But the correction is only starting in Japan, as output rose at an 11% annual rate in the fourth quarter last year. Continued weakness in U.S. housing and autos could mean more output cutbacks and inventory paring among suppliers in Canada and Mexico. The emerging Asian economies, which are heavily leveraged

to global demand, may need to ease production a little more as well, says David Hensley, an economist at JPMorgan Chase.

As manufacturers get output and stockpiles back in line with demand export growth could ease. In the U.S., overseas shipments of capital goods and industrial supplies would be most affected by any slowdown. Once the adjustments are complete, prospects should brighten, although the U.S. looms as a question mark: Businesses appear more cautious.

However, solid consumer demand worldwide has Hensley expecting global industrial production to grow 4% to 5% in the second half, with a speedup in exports. The downside from such a rebound: Higher rates of capacity use would lift inflation concerns among central banks, including the Federal Reserve. ■

—By James Mehring in New York

INVENTORY ADJUSTMENTS: A GLOBAL EVENT



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THE SUBPRIME SPECTER

On Mar. 13, Wall Street again gave in to fears that the subprime mortgage mess could take down the broader stock market and economy. With **New Century Financial** on insolvency's doorstep (its shares sank to 85¢), **H&R Block's Option One** arm in limbo, and the late-payment rate for subprime loans nationally at a four-year high, investors sold first and asked questions later. Bank stocks, brokers, homebuilders, retailers—they all got hammered. Tuesday's 243-point plunge in the Dow was the second-largest since 2003 (photo, traders on the floor) and came less than three weeks after a 416-point dive. A key volatility reading has jumped 80% in less than a month. On Mar. 14 the market gyrated to a 57-point gain.

With the subprime horse already hoofing it miles away from the barn, Congress is on the case—threatening subpoenas and investigations. On the bright side: Fewer annoying mortgage pop-up ads and spam are clogging computers.

See "Making sense of the mortgage mess," page 34, "Option One's dwindling options," page 36, "Subprime is a downturn, not a meltdown," page 38, **ONLINE** "The mounting uncertainty over subprime," www.businessweek.com/go/tbw

Bush's Southern Tour

During President George W. Bush's Mar. 8-14 swing through Latin America, he cultivated **Brazilian President Luiz Inácio Lula da Silva** as a moderate counterweight to **Venezuela's Hugo Chávez**, and trumpeted a new Central American trade pact in Guatemala. He also got an earful from political leaders who said that while trade and investment are well and good, immigration reform is crucial. **Mexican**

President Felipe Calderón told Bush on Mar. 13 that building a fence along the border was not a solution. Bush heard the message: "I'm going to keep repeating it while I'm here in Mexico—that I know our country must have comprehensive immigration reform," he said. He pledged to push Congress to approve a guest-worker bill in August.

ONLINE "Immigration reform: Bush's big promises," www.businessweek.com/go/tbw

SarbOx Under Fire

More rumblings against **Sarbanes-Oxley**: On Mar. 12-13 business leaders including **uber-investor Warren Buffett** met with **Vice-President Dick Cheney**, **Treasury Secretary Henry Paulson Jr.**, and other top officials to press for easing the pinch of post-Enron laws so that U.S. capital markets can regain competitiveness. On Mar. 12 a **Chamber of Commerce** report issued a similar clarion call for reforms.

Schering's Tonic

Drugmaker **Schering-Plough**, or weakened by legal woes and limping sales, put an exclamation point on its recovery with a major purchase. On Mar. 12 said it would pay \$14.4 billion for **Organon BioSciences**, a unit of Netherlands-based **Akzo Nobel**. **Organon** will give Schering a strong footing in women's health, not to mention a pipeline of five experimental drugs.

ONLINE "Schering's risky growth gambit," www.businessweek.com/go/tbw

Where Peltz Is Nibbling

Will **Cadbury Schweppes** make a tasty morsel? Rumors that the candy and beverage maker could get eaten have abounded for months. On Mar. 13 the news that **Nelson Peltz** has amassed a 2.98% stake added new fizz to the speculation. Peltz's **TriStar Management** has pressured **Heinz** to boost shareholder value, and expectations that he'll push for a split-up of **Cadbury** sent shares leaping 10%.

ONLINE "Cadbury Schweppes soars on Peltz stake," www.businessweek.com/go/tbw

Halliburton's New Home

Long a lightning rod in Washington, **Halliburton** invited a new blast of criticism with its Mar. 11 announcement that it's setting up a headquarters in **Dubai**. Democrats, of course pounced on the news, speculating that **Vice-President Cheney's** former employer wants to evade taxes. The oil services giant insisted it would remain a U.S. company with its headquarters in Houston and that anticipates "absolutely no tax benefits." Still, congressional hearings are expected.

KKR Wants More Stores

For all the handwringing over whether the subprime mess will curb consumers, there's one buyer hitting the aisles: **Private**

quity firms. On Mar. 12, **Dollar General**, a Tennessee-based discount chain, said it had agreed to be acquired for \$7.3 billion by buyout firm **Kohlberg Kravis Roberts**. The sale follows similar deals for **Linens 'n Things**, **Petco**, and **Sports Authority**, all retailers that—like Dollar General—had tumbled and were quickly napped up.

Lands Off Our Clips!

On Mar. 13, **Viacom** filed suit in federal court in New York against **Google** and its online video unit, **YouTube**, charging that they “willfully infringe copyrights on a huge scale.” See “*Can Redstone beat ‘em and win ‘em?*” page 46

Black Ink in Detroit

General Motors has shifted out of reverse and into first gear, showing a \$2.2 billion operating profit last year. Throw in restructuring costs and other one-timers, and GM still lost \$2 billion. That's a fine recovery from the \$10.4 billion loss in 2005, but a lot of repair work lies ahead. Its long-suffering North American business lost \$779 million last year. Meanwhile, crosstown rival **Ford** sold its luxury **Aston Martin** division for a much-needed \$848 million.

ONLINE “After *Aston*, could Jaguar be next?”

www.businessweek.com/go/tbw

Dunn Walks

All charges against former **Hewlett-Packard** Chairman **Patricia Dunn** related to the company's boardroom-leak scandal were dropped by a California state court on Mar. 14. Three others—former HP attorney **Kevin Hunsaker** and private investigators **Ronald DeLia** and **Matthew Depante**—pleaded no contest to one misdemeanor count of fraudulent wire communications. Those charges will be lifted after they serve 96 hours of community service. Each had faced four felony counts.

Trump May Unload

Has **The Donald** decided it's time to cash in his chips in **Atlantic City**? On Mar. 12, **Trump Entertainment Resorts** said it had hired **Merrill Lynch** to study strategic alternatives for the three hotel-casinos it operates. The company has lost nearly \$100 million from continuing operations since emerging from bankruptcy in 2005.

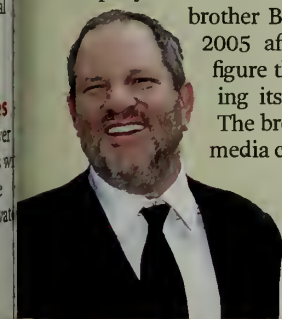
Press Lord on Trial

Lord Conrad Black is getting his day in court. On Mar. 14 jury selection began in the Chicago trial of the newspaper magnate and ex-chief of **Hollinger International**, now called **Sun-Times Media**. He and three colleagues face federal charges, including racketeering, in the alleged whisking away of \$84 million.

FASHION STATEMENT OF THE WEEK

Harvey Weinstein apparently doesn't like being upstaged. The larger-than-life movie producer and co-chairman of **Weinstein Co.** on Mar. 12 joined with private equity firm **Hilco Consumer Capital** to buy the fabled **Halston** couture house for an undisclosed price. Weinstein, whose company produced the reality show **Project Runway** for Bravo, has quipped that he takes a back seat to his girlfriend, British designer **Georgina Chapman**, when the two venture into high-end fashion shows. Now, Weinstein intends to help turn around the 41-year-old house that made turtlenecks, pillbox hats, and **Ultraseuede** chic. Weinstein will sit on the board along with **Jimmy Choo** founder **Tamara Mellon**, who brought the idea to Weinstein and will serve as creative guru while Hilco operates the company until a CEO is named. Weinstein and his partner-brother Bob, who left their **Miramax** studio in 2005 after squabbling with owner **Disney**, figure they can spiff up Halston by marketing its garments in films and TV shows. The brothers' dream: to build a full-fledged media company.

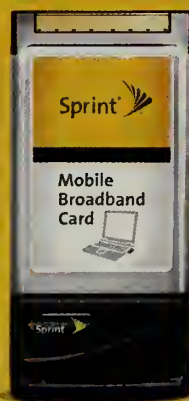
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THE ECONOMY

MAKING SENSE OF THE MORTGAGE MESS

Defaults are soaring, stocks are tanking, and fear is on the march. How far will the pain spread? **BY MARA DER HOVANESIAN, PETER COY & MATTHEW GOLDSTEIN**

WHEN GENERAL Motors Corp.'s fourth-quarter results missed analysts' estimates on Mar. 14, the reason probably took some people by surprise: mortgage loans gone bad. Although the world's No. 1 automaker posted its fattest profits in three years, the news was overshadowed by a \$651 million shortfall in its subprime mortgage unit.

In the past few months, subprime specialists New Century Financial, Fremont Realty Capital, NovaStar Financial, Accredited Home Lenders, and at least a dozen others have seen their stocks plummet as they've announced major losses, exited the business, put themselves up for sale, or declared bankruptcy. As the blowups mount, fears are growing that the carnage isn't over. On Mar. 13 the Mortgage Bankers Assn. reported a record percentage of mortgages entering

foreclosure in the fourth quarter—news that sent the Standard & Poor's 500-stock index tumbling 2%.

Nonetheless, in the broadest sense, say economists, the economy should be able to withstand the downdraft in the mortgage market. "It's going to have limited impact," says David A. Wyss, chief economist of Standard & Poor's, which, like *BusinessWeek*, is a unit of The McGraw-Hill Companies. But he's quick to add: "That doesn't mean none."

Indeed, the list of losers seems to be growing every day, from the Wall Street banks that extended credit and the investors who gorged on mortgage-backed securities to the shareholders, big and small, of failing lenders. And don't forget the home buyers themselves, who busted their budgets to buy more home than they could afford and now face the possibility of foreclosure. They all stand to suffer in the months ahead.

The good news is that, although the subprime business has grown rapidly

ILLUSTRATION BY GARY NEILL



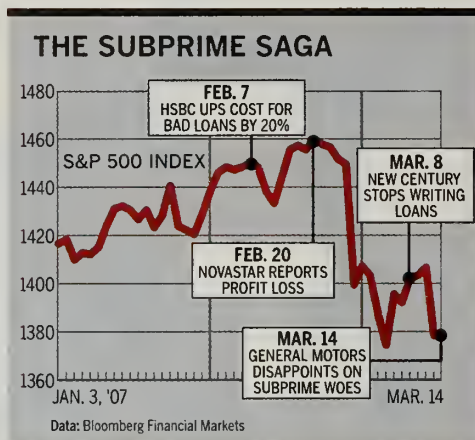


in recent years, it remains a small part of the overall mortgage market—14% of outstanding mortgage loans. And only some subprime loans are in trouble. About 13% were past due in the fourth quarter, the Mortgage Bankers Assn. said. So the most serious damage is confined to a fraction of a sliver of the overall mortgage market. Christopher L. Cagan, chief economist at Santa Ana (Calif.)-based First American CoreLogic, projects mortgage defaults of about \$300 billion through 2010, just a flea on the nation's \$10 trillion housing elephant. And about two-thirds of the losses will be recovered when lenders repossess homes.

GLASS HOUSING

ORDINARILY, ECONOMISTS get alarmed when subprime does badly, assuming borrowers with weak finances can't make their mortgage payments because the underlying economy is weak. It's different this time because the main culprit is lax underwriting standards. The overall economy is doing reasonably well, creating 97,000 jobs in February, according to the Bureau of Labor Statistics. The unemployment rate is just 4.5%. Subprime's woes aren't an indicator of deeper-seated problems.

In fact, the prognosis for the "prime" mortgage market seems positive, despite an uptick in defaults. From Feb. 1 through Mar. 8, as the subprime market



got sicker, rates on 30-year prime fixed mortgages fell, to 6.14% from 6.34%, according to Freddie Mac. Families are taking advantage of those low rates. The Mortgage Bankers Assn. said on Mar. 14 that its weekly index of applications was up 19% from the same time last year.

Bears worry that the subprime turmoil could deepen the housing slump, stripping a point or two from gross domestic product. The downturn in construction is already the biggest drag on growth, affecting everyone from carpenters and plumbers to furniture salespeople and attorneys. If families with poor credit stop buying because they can't borrow, it will further delay the rebound in homebuilding and associated industries. David Rosenberg,

chief North American economist Merrill Lynch & Co., who is among the more bearish economists on Wall Street, wrote on Mar. 14 that "it not inconceivable" that house prices will fall 10% this year, which he estimates would cause economic growth to slump to about 1.75% in 2007 from 3.3% in '06. Writes Rosenberg, "That's not a classical recession, but it's what we call a growth recession." Wyss of S&P thinks the weakness in housing, compounded by subprime problems, will slow economic growth to 2.4%, though he recently raised his estimate of the probability of a recession starting in the next

months to 30%, from 25%.

Paradoxically, the flight to the safe Treasuries, sparked in part by the subprime mess, may actually help the over-economy by lowering interest rates. Grady Jensen, co-chief investment officer of Bridgewater Associates Inc., a large manager of institutional investments, wrote in a report to clients on Mar. 14: "Our guess is that the current bond rally will do more to fuel global growth than the subprime problems will do to slow it."

That's not to say the pain won't be severe for those closest to the subprime market's excesses. Subprime borrowers once-speculative hot spots are especially vulnerable. In markets like Honolulu, Las Vegas, Southern California, Washington

LENDER FOR SALE

Option One's Dwindling Options

BY MARA DER HOVANESIAN

H&R Block Inc. CEO Mark A. Ernst slapped a for-sale sign on Option One Mortgage Corp. back in November, confident he could get \$1.3 billion. At a conference on Jan. 9 he assured investors that the subprime lending arm was "drawing strong interest from very sophisticated buyers." But as of mid-March, no formal bids have been announced and prospects look bleak.

Investment bankers familiar with the sale say big Wall Street players have taken a pass. Two weeks ago, top-tier private equity players started sniffing around, but the chances of a deal seem remote. "Nothing that has happened suggests it can sell Option One for anything approaching the

\$1.3 billion book value," says Gimme Credit analyst Kathleen Shanley.

H&R Block would not comment. But Ernst reiterated he would get top dollar for the mortgage unit on CNBC on Mar. 14. Wall Street remains doubtful: "He's out of touch with reality," says Ivan Feinseth of Matrix USA, a New York research shop.

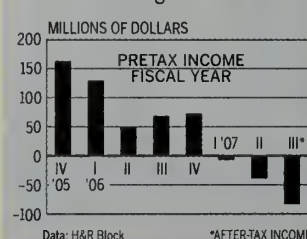
Complicating matters, state regulators are cracking down. Option One voluntarily stopped doing business in Rhode Island after the state passed new

predatory lending laws. Iowa enacted similar rules in February. Meanwhile, Minnesota's Commerce Dept. has started taking a closer look at the practices of subprime lenders,

including Option One—a move, regulators say, prompted in part by a Dec. 25 *BusinessWeek* article on the problems of Option One customers Randy and Jennifer Rimstad of Minnetonka, Minn. The worst-case scenario: States like Minnesota start issuing cease-and-desist letters that prohibit Option One from writing loans in those areas. Mortgage Lenders Network, based

A HOUSE IN SHAMBLES

H&R's mortgage business, largely Option One, has crumbled along with the housing market



C., and much of Florida, mortgage payments account for more than a third of income, vs. the national average of 16%. In California, one in five homeowners forgoes more than 50%. These home buyers are "starting to freak out," says Pamela D. Simmons, a real estate attorney in Soquel, Calif., near Santa Cruz. She sees about 20 stressed home buyers a month, up from a handful six months ago.

The lenders that made the riskiest loans—and their employees—are on shaky ground, too. Meanwhile, players in other parts of the credit markets are anxiously watching. "One of the risks is that people panic and take their money home," says Wyss.

INNOCENT BYSTANDERS'

INVESTORS continue flocking to the safety of Treasuries, the subprime mess would claim a surprising victim: private equity firms, which have been issuing gobs of junk bonds and loans to finance the leveraged buyout boom of the past few years. Lower demand for those could dampen the LBO craze, which has been supporting stock prices. So far the dislocations have been minor. Risk premiums for junk debt have increased a bit, says Jensen, but the change is barely visible in multiyear charts. Steven Miller of S&P's leveraged

finance unit says it's too early to tell what might happen.

But it's not too early to count the losses among mutual funds, Wall Street banks, and hedge funds, which appear to have been blindsided by the subprime sell-off. Citigroup bought New Century shares just a few weeks before they plunged to 69¢ after the lender stopped making new loans and its credit lines were pulled. Mutual fund companies Vanguard Group and Hotchkis & Wiley Capital Management were also big holders. Hedge fund Farallon Capital Management amassed a 7.8% equity stake in Accredited Home Lenders, whose shares have plunged 85% this year. The funds with biggest stakes in Fremont, whose stock has fallen 59% this year, include Fidelity, Vanguard, and Putnam Investments.

Holders of the individual stocks are hurting, too. Alan Gold, a Chicago area commercial real estate broker, bought New Century shares two years ago. In the past month, New Century has said it would restate its 2006 earnings, disclosed a federal criminal investigation into its accounting practices and trading in its securities, and said the SEC has launched an investigation. "As investors

Maria Bartiromo interviews Countrywide CEO Angelo Mozilo, page 142

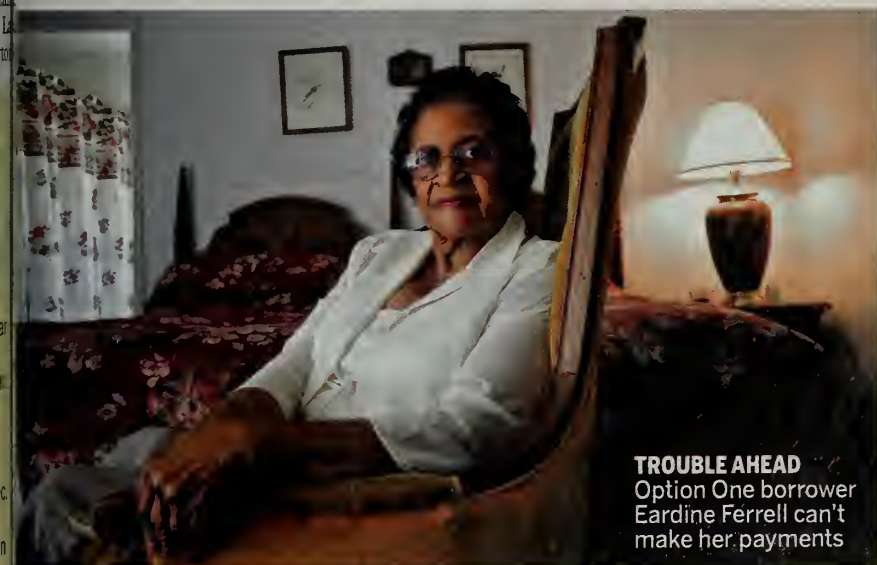
we were innocent bystanders," says Gold, "relying on the audits and the so-called reputation of New Century."

As usual, the worst damage is being felt by those closest to the fire. The larger economy, at least so far, has only been singed.

The biggest winners? Without a doubt, they're the top executives at subprime lenders who sold shares before the collapse. Over the past eight months five directors and officers at New Century sold shares worth about \$29 million, with most of the selling coming between August and November, when the stock was flying high. One of the biggest sellers was co-founder and Vice-Chairman Edward F. Gotschall, who grossed in \$19.3 million. Gotschall did not return phone calls seeking comment.

The sellers at New Century weren't the only subprime executives heading for the exits before the roof fell in. Edward W. Mehrer, a director of NovaStar Financial Inc., grossed more than \$1.1 million from sales from November through January. His last trade was on Jan. 23, when he sold 8,000 shares, generating \$172,080 in proceeds. On Feb. 21, NovaStar's stock plunged 43% after it reported an unexpected fourth-quarter loss and offered a dismal outlook for 2007. A NovaStar spokeswoman declined to comment. ■

—With David Henry in New York



TROUBLE AHEAD
Option One borrower Eardine Ferrell can't make her payments

Middletown, Conn., closed after, among other things, at least eight states handed out such orders. There's a similar pattern at New Century Financial Corp., which was delisted from the New York Stock Exchange on Mar. 13. "It's a tough time to be selling," says Scott Schneeberger, an analyst with IBC World Markets.

The slide has been steep for Option

One, which H&R Block bought for \$218 million in 1997. For years it was the company's breadwinner, banking \$2.8 billion of pretax earnings made largely during the housing boom from 2003 to 2005; at its peak, the group accounted for 60% of its parent's profits. But as the market has turned, the unit, which H&R Block now refers to as "discontinued

operations," has soured. In the three months ending on Jan. 31, the mortgage business, largely Option One, posted a \$162 million pretax loss, its third consecutive quarter in the red.

The losses couldn't have come at a worse time for H&R Block: Its primary business, tax preparation, has struggled in recent years. The stock has cratered by almost 20% since the beginning of February. "If the deal doesn't go through, the stock will be hit again," says Michael Millman, an analyst with the independent firm Soleil Securities.

Should H&R Block manage to find Option One a home, the buyer picks up a portfolio packed with risky borrowers like Eardine W. Ferrell of Lannett, Ala. The 71-year-old, who gets by largely on Social Security and odd jobs, saw the rate on her Option One mortgage jump from 9% in February, 2004, to 13.5% as of Mar. 1—doubling her monthly payment to \$986. She says she simply doesn't have the money. "They ain't going to do nothing but take my house."

COMMENTARY

BY MICHAEL MANDEL

This Is a Correction, Not a Meltdown

Unless the damage spreads, let's not overreact to subprime's travails



"MELTDOWN" IS A VIVID word, isn't it? It must be, or market pundits and financial writers wouldn't use it so often. Meltdown conjures up images of Three Mile Island or Chernobyl, where all that remains in the aftermath is a useless radioactive hulk. But financial meltdowns like the current subprime

crisis have turned out to be far less long-lasting than the nuclear variety. That means the right move for the smart stock-market investor with a broad portfolio may be the simplest one: Stand pat.

Yes, the Dow Jones industrial average has dropped by 5% over the past three weeks. But investors have suffered through 10 or so real or threatened "meltdowns" over the past 20 years, starting with the market crash of October, 1987, and continuing through the dot.com bust. Who can forget the Mexican peso crisis of 1994-95, the Asian financial crisis of 1997, or the Russian ruble crisis of 1998, which helped send the Dow plunging by more than 13% in less than a month?

In the end, all the meltdowns except the tech bust have been made up for by the upward trend line of the stock market. The 1987 stock market crash, so horrifying at the time, looks like a mere blip in retrospect. Even factoring in the long post-2000 bear market, the 20-year average return on Standard & Poor's 500-stock index, including invested dividends, is 10.6% per year. If you had invested in the stock market right after Alan Greenspan gave his "irrational exuberance" speech in December, 1996, and kept it there until now, you would have enjoyed an average annual return of 8% per year.

The long-term gains for investors over the past two decades come from two factors: strong productivity growth, which has propelled profits; and the

lack of a financial debacle big enough to inflict a Chernobyl-type disaster on the markets. It's noteworthy that the one period with a stagnant stock market, the decade from 1972 to 1982, also happens to be the weakest decade for productivity growth since World War II.

So the real question to ask is this: How does the crisis in the subprime mortgage market stack up against previous meltdowns? Is this going to be the Big One?

The short answer is, not likely. In a Feb. 20 speech Federal Reserve Governor Susan Schmidt Bies estimated that subprime adjustable-rate mortgages, which are the heart of the problem, make up just 7% to 8% of the total home mortgage market. Still, in absolute terms the size of the defaults could be enormous. Some estimates suggest that banks and other lenders could take a hit of \$300 billion more.

But remember, the tech bust devoured about \$9 trillion of corporate equity; next to that, the subprime problem looks

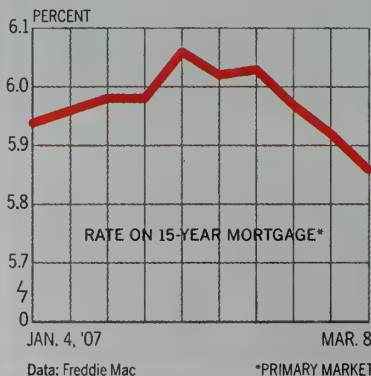
like an insect bite—unless it spreads to the rest of the mortgage market. But at least so far that doesn't appear to be happening: Mortgage rates for good borrowers have actually been going down. In early February, for example, the average rate for 15-year fixed rate mortgages was 6.06%, according to Freddie Mac. As Mar. 8, that was down to 5.86%. If low rates continue, they should actually prop up most of the housing market.

I don't want to be too Pollyannaish about either the stock market or the economy. There are plenty of dangers with the biggest one being the slowing U.S. productivity growth in recent months. If productivity growth slides even further, it could undermine corporate profits, the economy, and the stock market. But at least for now, the subprime meltdown doesn't look like a reason for investors to dive for the fallout shelters. ■

Despite all the "crises," the S&P 500 has returned 10.6% a year since 1987

NO CREDIT CRUNCH YET FOR GOOD BORROWERS

Despite the subprime troubles, mortgage rates are well below their recent highs.



A close-up portrait of Jim Bakke, a man with dark, wavy hair, wearing a suit and tie, looking directly at the camera with a slight smile.

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TRUSTED UBS's Guttenberg had an inside track on stock research

INVESTMENT BANKS

UBS: NOTES ON A WALL STREET SCANDAL

How the lines between stock research and marketing can still blur so easily

BY MATTHEW GOLDSTEIN

MITCHEL S. GUTTENBERG looked like a model banker. The 42-year-old was an executive director at UBS. He and his wife, Susan, have an apartment in Manhattan and a \$1 million home in the Hamptons. They were top donors to Learning Leaders, a charity that pays for tutoring services for New York City public school children.

But federal prosecutors allege that for five years, Guttenberg has been padding his \$300,000 or so annual salary by selling confidential stock research. On Mar. 1, they charged him with masterminding an insider trading scheme in which he allegedly tipped off two traders to upcoming ratings changes on hundreds of stocks—allowing them to trade ahead of the news. People close to the investigation say Guttenberg pocketed more than \$1 million in cash, all told. He got the inside dope, say authorities, from his perch on an elite committee at UBS that signed

off on all upgrades and downgrades.

Prosecutors are trumpeting the arrests of Guttenberg and 12 others as the biggest trading scandal since the days of Ivan F. Boesky. But there's a big difference between Guttenberg and Boesky, a master Wall Street trader. Despite the title, Guttenberg was essentially a glorified marketing executive, say people familiar with his duties. One person referred to him as a "traffic cop," responsible for making sure research was directed to the right investors. Other parts of his job: lobbying large institutions to vote for UBS analysts in the stockpicking competitions run by *Institutional Investor* and other publications, as well as getting analysts more exposure in the media.

Trained as a broker, Guttenberg had an undistinguished record before joining UBS's team in 1999. Over the first 12 years of his career he flitted from job to job,

starting out at Lehman Brothers and Bear, Stearns & Co. before moving on to Axiom Capital Management Inc. and First Albany Corp.

He seemed to have found a groove at UBS. Two years after joining the Switzerland-based firm, which has 78,000 employees worldwide, he was tapped to serve on a prestigious 12-member investment research committee. It was a placement reflecting a high level of trust. Authorities allege the insider trading scheme was hatched during Guttenberg's first year on the committee. He's currently on unpaid leave after pleading not guilty to six counts of securities fraud, a conspiracy and posting a \$500,000 bond. His lawyer, Sean O'Shea, declined to comment.

How could UBS seemingly have gotten so wrong in elevating Guttenberg to such a sensitive post? While the firm declined to comment, there was little in his past to indicate he would engage in anything like the scheme described by prosecutors. In 1986 he ran afoul of Wisconsin regulators over an allegation he was selling stocks without the proper license. In 1997, while at Axiom, he was named a defendant in a \$2 million arbitration claim filed by a big investor that alleged excessive trading in its account. Guttenberg was dropped from the dispute because he was only a "sales assistant," and the claim was subsequently dismissed. Four years later, he was sitting on the investment research committee at UBS.

Banks need to pick candidates for their most sensitive committees more carefully. "You'd think they'd be full super analysts," says Jacob Zamansky, an attorney who has taken part in

arbitration cases involving analysts and investors. "But it's my impression there is [a lot of] marketing associated with the committees." Wall Street rarely discusses its rating process.

The irony is that Wall Street firms paid \$1 billion in 2003 to set charges that analysts had conspired with investment bankers to issue favorable ratings. In effect, the

firm had been using stock research to sell themselves to prospective investment banking clients. But as the UBS scandal shows, Wall Street's pitchmen may still find ways to overstep their bounds. ■

THE STAT

\$14

MILLION

Profits allegedly made in a UBS trading scheme.

Data: Securities & Exchange Commission

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VIRTUAL WORLD

THE NEW AVATAR IN TOWN

Korea's Nexon and others are edging onto Second Life's turf, using simplified features

BY REENA JANA

CYNDI LESTER, 20, RECALLS her first meeting with future husband, Frank: "My avatar walked past his. He noticed me and typed: 'I like your hair.'" After their real-life wedding last year, Cyndi and Frank bought digital rings and staged a second, virtual-world wedding.

It all happened in MapleStory—a fantastical online game where players hunt cartoon monsters and communicate in text. For Lester, a Huntington (W.Va.) homemaker who devotes three to six hours a day exploring this two-dimensional universe, the allure of MapleStory is more about show than shoot-'em-up. She spends up to \$100 a month buying new clothes (at 9¢ to \$7 apiece) and hair-styles (\$5.70) for her digital double.

Suddenly it looks as if Second Life, that 3D virtual world that last year became a favorite hangout for hard-core techies and trend-watching corporations, has competition. A new crop of online multiplayer games is coming, targeting a broader audience with simpler navigation and customization than Second Life.

These games also rule out lewd behavior. The companies behind them have a novel way of making money, selling digital goods such as avatars and their outfits. The games themselves are free.

The mainstreaming of virtual worlds started, as so many consumer-tech stories do, in the Far East. MapleStory, from Korean online game maker Nexon Corp., has been a hit in Asia since 2003. The company's U.S. arm began marketing a North American version last September, riding the virtual-world bandwagon after Second Life started grabbing headlines. It now has more than 3 million North American players, joining a further 50 million worldwide. Nexon is best known for KartRider, a three-year-old online

go-cart racing game that has been wildly popular in South Korea. A U.S. version due out later this year. In 2005, Nexon had worldwide revenues of \$230 million, 85% of it from virtual items.

Starting in the fall, Sony Corp. will offer PlayStation Home—a realistic 3D online world where players can buy digital items such as T-shirts and Sony Bravia TVs—as a free download for its PlayStation 3 videogame console. And Nintendo of America is betting on the free, easy-to-use design avatar feature of its popular Wii console to attract older nongamers.

The rise of the avatars coincides with explosive growth for "massively multiplayer" online games in general. The category, which includes technically simple and nonviolent "casual" games as well as more graphically complex shooter games, is expected to produce revenues of \$700 million this year in North America alone and nearly triple that in four years, says videogame researcher DFC Intelligence.

A SNAP TO OPERATE

THE NEW MULTIPLAYER games are tailored for nontechies. Simple images like MapleStory and KartRider don't require sophisticated graphics cards or ultrafast Internet connections. Avatar details are a snap to customize with drop-down menus for selecting things like "curly hair" pigtailed or red rubber boots.

Nexon waited to court American players until "broadband reached critical mass," says John H. Chi, Nexon America Inc. president and CEO. But the company also needs to broaden its market. KartRider's popularity in Korea has been waning—many as 100,000 Koreans log on at a time today, vs. 200,000 in 2005.

Now the question is, will Americans spend real money in virtual worlds? (Other games rake in subscriptions or download fees.) MapleStory "was a litmus test to see if U.S. audiences would have a spending pattern similar to Korea," says Min Kim, Nexon America's director of game operations. "To make it easy, Nexon Cash cards, which are used to buy digital goods, are being sold at Target stores."

So far, so good: In February, North American players spent \$1.6 million on 600,000 virtual products within MapleStory.

—With Moon Ihlwe in Seoul

THE STAT

600,000

Number of avatar items bought in February by North American players of MapleStory

Data: Nexon North America Inc.

Lester met her real-life husband when his avatar admired hers



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LADIES AND GENTS... MARCUS BUCKINGHAM!

The business sage is spreading his gospel via a bus tour—and eyeing wider audiences

BY JENA MCGREGOR

IN HIS 18 YEARS ON THE ROAD, bus driver Allen Rushing has chauffeured his share of pop stars, from '80s-era hitmakers such as Sheena Easton to hip-hop artists and their entourages. The weathered Rushing, 61, was behind the wheel for Ozzy Osbourne's "No Rest for the Wicked" tour. And during thrash-metal band Anthrax' tour for their *State of Euphoria* album, he donned a giant mask and appeared onstage as the Not Man, the band's cartoonish, slightly demented-looking icon.

Rushing's most recent passenger isn't exactly a rock star. But to the 200 human resources managers and organizational consultants gathered near the King of Prussia Mall outside Philadelphia on a recent snowy morning, Marcus Buckingham is the next best thing. A charming, blue-eyed, silver-tongued Brit, Buckingham, 41, is arguably the business world's most in-demand management guru. His first book, 1999's *First, Break All the Rules*, has been a best-seller for 93 months. He has won near-reverential praise from CEOs. He lives in Beverly Hills, rakes in somewhere between \$50,000 and \$75,000 a speech, and is no stranger to the inside of a corporate jet.

All of which makes Buckingham's 21-city bus tour, during which he'll speak to local human resources managers,

an unusual move. But the Cambridge-educated Buckingham is no ordinary management sage. The former Gallup Organization researcher is using the tour to send up trial balloons about taking his message beyond the executive suite to a much wider audience. To help attract followers who might not otherwise pick up a management book, such as teachers and students, Buckingham has made a series of six short inspirational films that feature himself. The films were de-



Buckingham outside the bus he's using for much of the tour

signed as a tool to complement his new book, *Go Put Your Strengths to Work*, a workbook-like guide he's promoting on his bus tour. From New York to Lincoln, Neb., Buckingham is stopping at multiplex theaters across the country to show the first short film and speak to standing-room-only crowds.

The members of Buckingham's entourage, which includes two employees, the writer who worked with him on his book, and the head of a girls' boarding school who is using Buckingham's insights

there, jokingly call themselves Buckingham's st. status, they make cracks about mocking up backstage passes.

But the irony dissipates when they talk about Buckingham's philosophy, which is built around the idea that the key to success is building on your strengths rather than trying to fix all your weaknesses. A corollary is the idea that managers should build teams that showcase members' strengths rather than try to create a team of equals. His concepts have been ingrained at such companies as Yahoo! and Best Buy.

Although Buckingham wrestles with how much he wants to spread the "strengths movement" beyond the corporate world, the possibility of winning a wider audience intrigues him. "This tour is about figuring out whether that's what people want from me," he says.

It appears they do. Churches have been snapping up the short movies, which were shot by a nonprofit called NOOM that makes Christian films. And Patricia F. Bassett, president of the National Association of Independent Schools, which represents some 1,300 schools, has invited Buckingham to be a keynote speaker

at the group's annual conference.

After Buckingham addresses the audience at the multiplex near Philadelphia, his first questioner is the owner of a salad and day spa who wants to know if Buckingham is going to apply "this work to our children." Calling his ideas "profound," she asks: "How can we help the young ones?" That's a great question, Buckingham replies. "That's where I think we have to go next."

Back on the bus, Buckingham changes out of one crisp dress shirt in another, pulls on a red hoodie from his Malibu (Calif.) boutique Free City, and cracks open a beer. Rushing steers the bus out of the multiplex parking lot and heads toward Washington, D.C., but not before volunteering that he knows what his strengths are. "I'm a good mechanic," Rushing tells Buckingham. "And I'm good at staying in the background." ■

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COMMENTARY

BY RONALD GROVER

Can Redstone Beat 'Em and Join 'Em?

Viacom is suing YouTube as CBS scrambles to ink a deal with the video site

WHAT'S WRONG WITH THIS picture? On Mar. 13, Viacom sets off a legal depth charge and sues YouTube for \$1 billion. The Google-owned unit is "stealing value," the complaint alleges, by airing snippets of shows like its Comedy Central hit *South Park* without paying for the right. (Google disagrees, saying it is protected under so-called safe harbor provisions in the 1998 Digital Millennium Copyright Act.) Meanwhile, in the other part of Sumner M. Redstone's media empire, we have CBS literally cuddling up to YouTube. CEO Leslie Moonves actually hugged YouTube's Chad Hurley at a Las Vegas convention in January as the pair gigglingly viewed a "mash-up" of *Big Brother* and *CSI: Miami*.

Getting media moguls to agree is about as easy as picking a hit television show, so why should Moonves and his Viacom counterpart, Philippe P. Dauman, concur on YouTube? Yes, both want to get paid for content posted on the site, and the Viacom lawsuit is clearly a way of bringing Google/YouTube to the table. But if CBS and Viacom have radically different approaches to the world's most popular video service, it's largely because CBS believes it needs YouTube (at least for now) and Viacom believes it doesn't (unless it gets paid). We'll explain.

Even though both companies make most of their money from television, they're actually in very different businesses. CBS largely depends on weekly shows in the ad-starved world of network TV. Plus, its programs tend to skew older. So luring eyeballs to the network means everything. A little tease on YouTube can't hurt, which is why the guys from the Tiffany Network have set up pages for *Two and*

a Half Men, *Jericho*, and other shows. YouTube famously gave NBC's *Saturday Night Live* a boost last year with a short called *Lazy Sunday* that was seen by 5 million folks within days. you're Moonves, you want some of that. Moreover, while CBS declined to talk about this, Moonves' minions are working hard to ink a revenue-sharing deal with YouTube.

Over at Viacom, television is a volume business. Cable is seven-day-a-week, cram-it-down-your-throat affair. If *South Park* is great on Monday, it's even better on Tuesday, and maybe three times better on Thursday. In other words, when viewers know their favorite show is on several times a week, they don't need the promotional pop of a YouTube to get them to tune in. What's more, Viacom programming, whether borrowed from Comedy Central's *The Colbert Report* or MTV's *Punk'd*, is short, hence perfect for the clips YouTube trades in. Comedy

Central and MTV are only now getting video traction on their own Web sites; in fact, MTV.com reported record traffic and video streaming in February. Viacom doesn't want YouTube to draw away viewers.

CBS and Viacom both want the same thing: a deal that allows them to leverage YouTube's mass appeal while getting paid. But hammering one out could prove maddeningly difficult. It's no secret that Google/YouTube, despite months of negotiations with a number of parties, has yet to sign a revenue-sharing contract with any major U.S. film or TV studio. A few months back, Google suggested paying Viacom \$500 million a year over five years

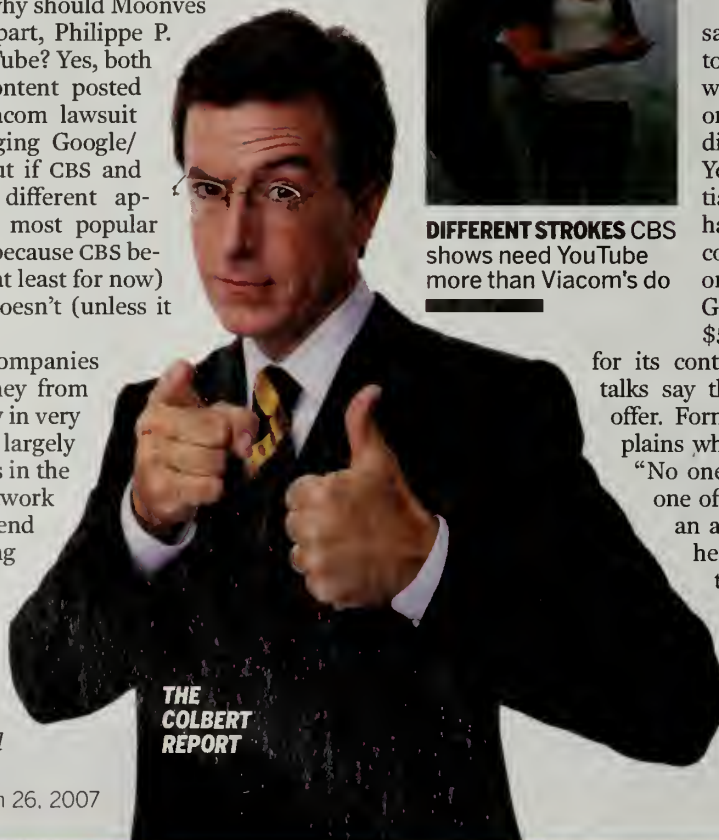
for its content, but people involved in the talks say the search colossus retracted the offer. Former CBS Chief Jeff Sagansky explains why it's so hard to get a deal done: "No one knows what an ad is worth on one of these sites where people click on an ad and head off somewhere else," he says. "Good luck finding a price they can agree on." Until someone figures this out, the legal fireworks will continue. After a while, Sumner Redstone is the man behind the curtain. ■

—With Tom Lowry at Robert D. H

JERICO



DIFFERENT STROKES CBS shows need YouTube more than Viacom's do



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DIGITAL CULTURE

NEW TECH, OLD HABITS

Despite world-class IT networks, Japanese and Korean workers are still chained to their desks

BY MOON IHLWAN AND KENJI HALL

MASANORI GOTO WAS in for a culture shock when he returned to Japan after a seven-year stint in New York. The 42-year-old public relations officer at cellular giant NTT DoCoMo logged many a late night at his Manhattan apartment, using his company laptop to communicate with colleagues 14 time zones away. Now back in Tokyo, Goto has a cell phone he can use to send quick e-mails after hours, but he must hole up at the office late into the night if he needs to do any serious work. The reason: His bosses haven't outfitted him with a portable computer. "I didn't realize that our people in Japan weren't using laptops," he says. "That was a surprise."

A few hundred miles to the west, in Seoul, Lee Seung Hwa also knows what it's like to spend long hours chained to her desk. The 33-year-old recently quit her job as an executive assistant at a car-maker because, among other complaints, her company didn't let lower-level employees log on from outside the office. "I could have done all the work from home, but managers thought I was working hard only if I stayed late," says Lee.

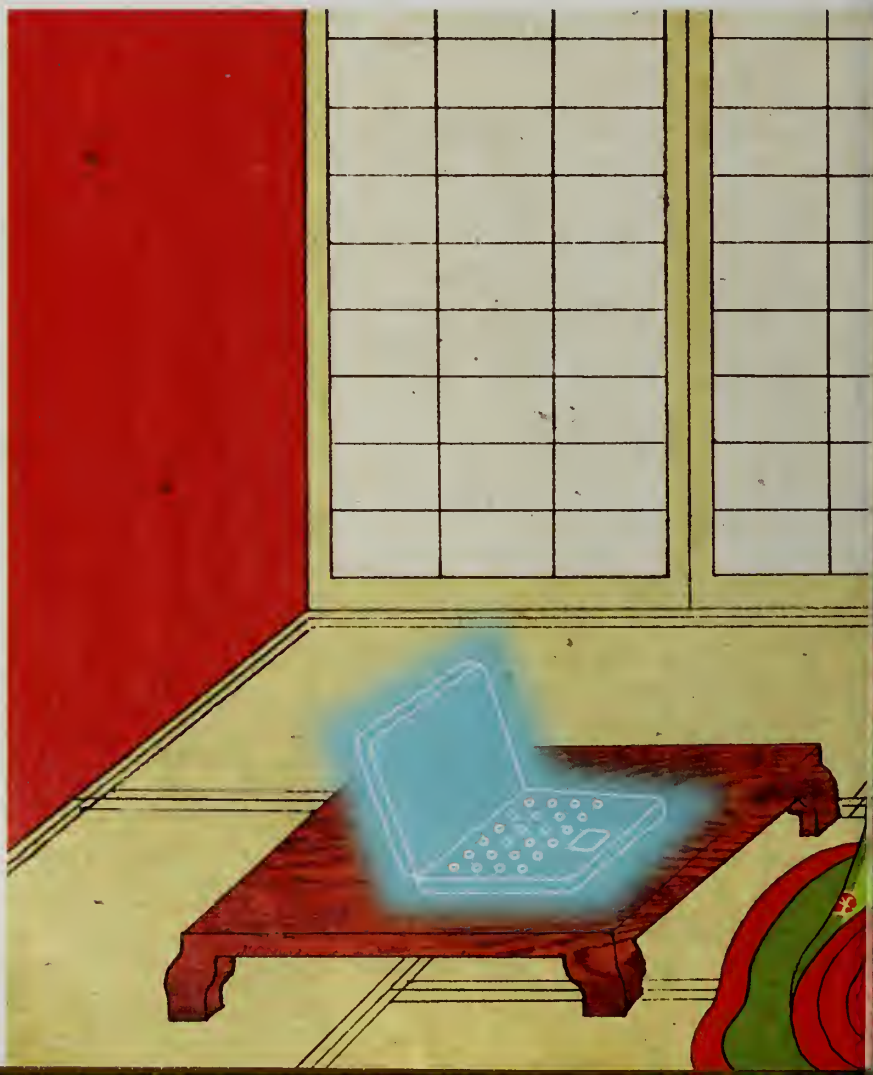
These days, information technology could easily free the likes of Goto and Lee. Korea and Japan are world leaders in broadband access, with connection speeds that put the U.S. to shame. And their wireless networks are state of the art, allowing supercharged Web surfing from mobile phones and other handhelds, whether at a café, in the subway, or on the highway. But when it comes to taking advantage of connectivity for business, Americans are way ahead.

For a study in contrasts, consider

the daily commute. American trains are packed with business people furiously tapping their BlackBerrys or Treos, squeezing a few extra minutes into their work days. In Tokyo or Seoul, commuters stare intently at their cell phone screens, but they're usually playing games, watching video clips, or sending Hello Kitty icons to friends. And while advertising

for U.S. cellular companies emphasizes how data services can make users more productive at work, Asian carriers tend to stress the fun factor.

Why? Corporate culture in the Far East remains deeply conservative, and most businesses have been slow to mine the opportunities offered by newfangled communications technologies. One b



reason is the premium placed on face time at the office. Junior employees are reluctant to leave work before the boss goes for fear of looking like slackers. Also, Confucianism places greater stock on group effort and consensus-building than on individual initiative. So members of a team all feel they must stick around "there is a task to complete. "To reap full benefits from IT investment, companies must change the way they do business," says Lee Inn Chan, vice-president at SK Research Institute, a Seoul management think tank funded by cellular carrier SK Telecom. "What's most needed in Korea and Japan is an overhaul in business processes and practices."

TIME, NOT TASK

IN THESE COUNTRIES, if you're not in the office, your boss simply assumes you're not working. It doesn't help that lack of clear job definitions and performance metrics makes it difficult for managers to assess the productivity of employees working off site. "Performance reviews and judgments are still largely time-oriented here, rather than

task-oriented as in the West," says Cho Bum Coo, a Seoul-based executive partner at business consulting firm Accenture Ltd.

Even tech companies in the region often refuse to untether workers from the office. Camera-maker Canon Inc. for instance, dispensed with flextime four years ago after employees said it interfered with communications, while Samsung stresses that person-to-person contact is far more effective than e-mail. In Japan, many companies say they are reluctant to send workers home with their laptops for fear that proprietary information might go astray. Canon publishes a 33-page code of conduct that includes a cautionary tale of a worker who loses a notebook computer loaded with sensitive customer data on his commute.

At Korean companies SK Telecom, Samsung Electronics, and LG Electronics, employees must obtain permission before they can carry their laptops out of the office. Even then, they often are barred from full access to files from work. And while just about everyone has a cell phone that can display Web pages or send e-mails, getting into corporate networks is complicated and unwieldy.

The result: Korean and Japanese white-collar workers clock long days at the office, often toiling till midnight and coming in on weekends. "In my dictionary there's no such thing as work/life balance as far as weekdays are concerned," says a Samsung Electronics senior manager who declined to be named. Tom Coyner, a consultant and author of *Mastering Business in Korea: A Practical Guide*, says: "Even your wife would think you were not regarded as an important player in the office if you came home at five or six."

These factors may be preventing Japan and Korea from wringing more productivity out of their massive IT investments. Both countries place high on lists

Bound by Tradition

Despite fast wireless and broadband networks, Korean and Japanese companies aren't getting the most out of technology. Here's why:

FUN FACTOR Smart phones are viewed more as toys than tools.

FACE TIME If you're not in the office, no one thinks you're working.

INFO-FEAR Companies worry that laptop-toting commuters could misplace sensitive data.

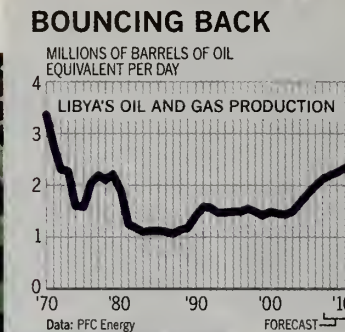
of global innovators. For instance, Japan and Korea rank No. 2 and No. 6, respectively, out of 30 nations in terms of spending on research and development, according to the Organization for Economic Cooperation and Development. And the Geneva-based World Intellectual Property Organization says Japan was second and Korea fourth in international patent filings. But when it comes to the productivity of IT users, both countries badly lag the U.S., says Kazuyuki

Motohashi, a University of Tokyo professor who is an expert on technological innovation. "Companies in Japan and Korea haven't made the structural changes to get the most out of new technologies," he says.

Still, a new generation of managers rising through the ranks may speed the transformation. These workers are tech-savvy and often more individualistic, having come from smaller families. Already, some companies are tinkering with changes to meet their needs. SK Telecom abolished titles for all midlevel managers in the hopes that this would spur workers to take greater initiative. Japan's NEC Corp. is experimenting with telecommuting for 2,000 of its 148,000 employees. And in Korea, CJ 39 Shopping, a cable-TV shopping channel, is letting 10% of its call-center employees work from home.

Foreign companies are doing their bit to shake things up. In Korea, IBM has outfitted all of its 2,600 employees with laptops and actively encourages them to work off site. The system, which was first introduced in 1995, has allowed the company to cut back on office space and reap savings of \$2.3 million a year. One beneficiary is Kim Yoon Hee. The procurement specialist reports to the office only on Tuesdays and Thursdays. On other days, calls to her office phone are automatically routed to her laptop, so she can work from home. "It would have been difficult for me to remain employed had it not been for the telecommuting system," says Kim, 35, who quit a job at a big Korean company seven years ago because late nights at the office kept her away from her infant daughter. "This certainly makes me more loyal to my company." ■





MELLITAH ENI's complex is the envy of the oil industry

ENERGY

GOING FOR A GUSHER IN LIBYA

Italy's ENI is beating out giants like BP and ExxonMobil, partly because it never left

BY STANLEY REED

TO SEE WHAT MANY EXPECT to be the future of the oil industry, take a trip to the windswept coastal plains 60 miles east of Libya's capital, Tripoli. At Italian oil giant ENI's \$9 billion Mellitah complex there, flaring towers rise out of the scrubland and intricate webs of pipes weave across the landscape, feeding into an undersea pipeline to Italy. Further inland, there are apartments, a soccer field, and a basketball court for Mellitah's 550 workers.

Though ENI is the No. 7 international oil producer and has less than half the output of giants such as ExxonMobil or BP, its operations at Mellitah and elsewhere in Libya are the envy of the industry. Unlike U.S. companies, which had to leave when Washington hit Libya with sanctions in 1986, ENI has maintained a presence there since the late 1950s. Today, ENI enjoys a commanding lead in

the country, where it produces the equivalent of 600,000 barrels of oil per day, or roughly a third of Libya's output.

Since Muammar al Qaddafi settled his differences with the U.S. three years ago, Libya has become one of the last great opportunities for global oil. Although the economy is far from open, everyone is scrambling to get in. Over the past three years, Libya has held three auctions for exploration rights and has signed deals with dozens of oil and gas companies, many of which had left because of sanctions. "Libya has huge potential," says Mark Hope, Royal Dutch Shell PLC's top official there.

RELATIVELY UNEXPLORED

THE IMMEDIATE attraction is Libya's 39 billion barrels in reserves. But the oil men are even more interested in what might lie undiscovered deep beneath the desert sands or in the Gulf of Sirte. After so many years of isolation, Libya remains relatively unexplored; techniques that

have been developed in recent years could well turn up immense new reserves. "The next five years will define the true picture of new oil in Libya," says Bindra. Thus an earth sciences professor at University College London who advises Libya's National Oil Corp.

How much is out there? Thus figures a further 65 billion barrels of oil could be discovered, which would put Libya in a league with Kuwait and the United Arab Emirates in terms of reserves. Even now, Libya's oil and gas production of about 2 million barrels per day is just over half its peak output in 1970. Consultants PFC Energy predict could rise to at least 2.4 million by 2010. Though Qaddafi still spouts anti-American invective, many say he likes working with U.S. companies. He believes "they're better at finding oil," says Bjorn Ursin Holm, who heads Mideast operations for Netherlands-based Fugro Group, which is doing marine seismic work in Libya.

There's plenty of exploration going on already. Exxon Mobil Corp. has agreed to survey vast stretches of seabed that it won in an auction earlier this year, and CEO Rex W. Tillerson recently met with Qaddafi as part of a big push in Libya. Oas Group, which includes Conoco Phillips, Hess, and Marathon Oil, paid \$1.8 billion in 2005 to return to properties the group left in 1986. Shell PLC meanwhile, has inked a package that allows the company to probe for gas in the Sirte Basin, and plans to spend \$100 million refurbishing a liquid natural gas plant.

While Libya has been applauded for the transparency of its auctions, they attracted so much competition that many winners wound up agreeing to unfavorable terms. Chinese Petroleum Corp., for instance, will get just 7.8% of oil output from its fields, much less than the 20% to 30% typical in Libyan auctions in the 1990s. "Some companies have used very low profitability criteria," says Philippe Malzac, managing director of Total Exploration & Production Libya.

By letting foreigners in quickly, Tripoli is hoping to build up the local oil industry to offset unemployment, which may be as high as 35%. ENI, for instance, is putting \$150 million into hospitals, schools, and archaeological work, and has agreed to train 150 Libyan engineers to work at its subsidiaries worldwide. Sure, that's a lot of extra cost to stay in the game. But for both sides, Libyan oil could be a big win. ■

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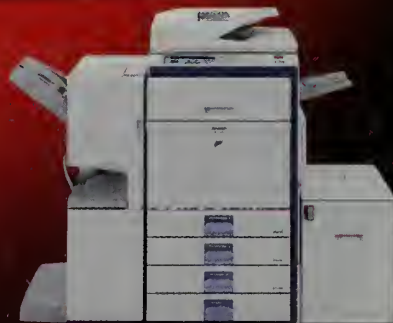
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BROTHERS

24 ROYAL
DUTCH

25 STARBUCKS

The Best Per

2007

This year's list is chock full of companies that are rewriting the rules in their industries. They are the agitators, the pioneers, and the game-changers that are leading the way in the 21st century

by Dean Foust

27	ORACLE
28	STARBUCKS
29	MOODY'S
30	PEPSICO
31	STRYKER
32	BEST BUY
33	UNITED PARCEL SERVICE
34	APPLE
35	T. ROWE PRICE GROUP
36	VALERO ENERGY
37	CONSTELLATION ENERGY GROUP
38	TJX
39	MORGAN STANLEY
40	PAYCHEX
41	COVENTRY HEALTH CARE
42	UNITED STATES STEEL
43	UNITED TECHNOLOGIES
44	HERSHEY
45	BLACK & DECKER
46	SYNOVUS FINANCIAL
47	LINEAR TECHNOLOGY
48	AT&T
49	XTO
50	PNC FINANCIAL SERVICES

formers

When it comes to anticipating fashion trends, many apparel makers rely on the intuition of a charismatic designer like Ralph Lauren or a savvy executive like Mickey Drexler. But not the folks at Coach Inc. Every year, the New York maker of women's handbags assiduously interviews more than 60,000 of its customers through Internet questionnaires, phone surveys, and face-to-face encounters with shoppers at the 300 stores. Such intense market research has helped Coach executives spot trends well before the herd, and this in turn has helped it to extend the brand far beyond the leather bags that long were its trademark and into watches, accessories, and clothing. After hearing customers complain that they couldn't find decent carry-on luggage for weekend getaways, for example, the company in July, 2006, launched its "Signature Stripe" travel bags—a new line that accounted for a hefty 15% of Coach's sales of full-priced merchandise during the first month out of the gate.

That ability to peer around corners ahead of competitors has paid off big for Coach shareholders: Sales have grown an average of 29% over each of the past three years, fueling a »



strong 63% averaged return on invested capital during the same period. Such stellar performance was enough to earn Coach the No. 2 spot in this year's BusinessWeek 50, our 11th annual ranking of the best-performing companies in the Standard & Poor's 500-stock index. "This research gives us a real competitive advantage," acknowledges Coach Chief Executive Lew Frankfort. "The only way for us to grow on a sustained basis was if we evolved as our consumers evolved."

Companies in the BusinessWeek 50 represent our choices as the "best in class" from each of the 10 sectors that make up the S&P 500. To select this year's star performers, we first ran companies through a proprietary screen that we refined this year to emphasize two measures—how well each company's management has been using the capital at its disposal and sales growth. We also chose only the best performers from each sector, to ensure that we were rewarding true management excellence and not just the ability to ride the wake of a hot sector. And to provide the wisdom, perspective, and common sense that computers can't, *BusinessWeek's* editors and reporters reviewed each company on the list, making a limited number of changes where necessary.

OUTSTANDING CLASS

THE RESULT MAY BE ONE of the strongest groups of companies in the 11 years that we've conducted this annual search for the best performers. The Class of 2007 is chock full of companies that are rewriting the rules of engagement in their industries. They are the agitators, the pioneers, and the game changers that are leading the way in the 21st century. Case in point: This year's top performer, Google Inc., is using the same mastery of algorithms that enabled it to dominate Internet search to launch innovative new services, including one brokering advertising for traditional media. The rankings also include dynamic companies such as Nucor (No. 4), which has deployed technology and cutting-edge

How We P

Any method for ranking companies will by necessity be imperfect. But for this year's BW 50 list, we have tweaked our methodology to better identify top performers, applying some of the lessons we've learned over the past 10 years.

First, we focused on two core financial measures, average return on capital and sales growth, both taken over the previous 36 months. For our measure of profits for nonfinancial companies we used earnings before interest and taxes. The earnings

measure also excludes distortions from special and nonoperating items as defined by our data provider Standard & Poor's Compustat. We put these profit numbers into perspective by figuring them as a percentage of the value of invested capital, but we excluded debt and share repurchases. For financial companies we calculated return on shareholder equity using pretax profits as our measure, the better to align figures with the nature of the industry. For our measure of sales growth for all companies we included gains from operations and from mergers and acquisitions, as reported by Compustat.

employee-incentive programs to stand the steel industry on its head, and Apple (No. 34), which is trying to revolutionize cell phones in the same way it did music players.

Our screening also produced the names of smaller companies playing at the top of their game, such as Rockwell Collins Inc. (No. 24) and Varian Medical Systems Inc. (No. 14). They're joined by outfits ranging from Best Buy (No. 32) to payroll manager

» Google is using its famed mastery of algorithms to launch innovative services



The first BW50 in 1997

flatter

flog

ed the 50

nd, we compared companies
hers in their sectors. (Ten
cover the companies in the
rd & Poor's 500-stock index.)
eak from our past practices
s us to identify companies
e good performers relative
peers, even if their sector of
nomy is not booming. This
the situation, for example,
oil companies jump to the
he list when oil prices are ris-
l then drop off the list when
es are falling.

tarted with nearly all the com-
in the S&P 500. We left certain
it of our analysis because they
come public too recently, such

as telecom Embarq; because they
had continuing accounting issues or
insufficient data; because they were
a government-sponsored enterprise,
such as housing lender Fannie Mae;
or because they are likely going to be
purchased, such as Biomet. Educa-
tion lender SLM was omitted because
it still had ties to the federal govern-
ment in 2004, within our three-year
window of analysis. The McGraw-Hill
Companies, *BusinessWeek's* parent,
was omitted as well, to avoid any ap-
pearance of favoritism.

Within each sector we ranked
companies separately by our two
measures—return on capital and
growth—and then combined the nu-

merical rankings, giving substantially
greater weight to return on capital.
The top company in each sector, ac-
cording to the combined ranking, was
given a 1, and the bottom company
received a 0, with all the intermediate
companies receiving a score accord-
ing to their ranking. For example,
Coach finished first in return on in-
vestment in the consumer discretion-
ary sector and third in sales growth,
which ended up making it the top
performer among its peers.

A list was then constructed of all
the companies we analyzed, accord-
ing to their scores. We applied a
tiebreaker where necessary. Finally,
this list was reviewed by a panel of

editors and correspondents, apply-
ing one thing we learned from 10
years of compiling the BW50: Fi-
nancial measures applied mechani-
cally sometimes miss the mark.
Based on extensive discussion, the
panel made a small number of ad-
justments in the ranking.

The new procedure does have
some quirks. A company such as
Sempra Energy may rank ahead of
a company with higher return on
capital and sales growth such as
Lehman. That's the result of focus-
ing comparisons within sectors,
which we think over the long run
will produce a more reliable list of
the best performers.

Paychex (No. 40) to Black & Decker (No. 45). What distinguishes
many of these organizations is a deep understanding of custom-
ers, a competitive advantage that has enabled them to sell more
goods and services than rivals.

Best Buy, for example, recognized that computer buyers were
nervous about fixing their desktop machines and developed its
popular Geek Squad home PC repair service. For Paychex, a tight
bond with customers has enabled it not just to manage payrolls
for its small-business customers but also to provide tax services
and benefits consulting. This type of constant innovation is in-
creasingly critical for companies, given the shrinking lifespan of
business plans. Chris Zook, head of the global strategy practice at
Bain & Co. and author of the forthcoming management book *Un-
toppable: Finding Hidden Assets to Renew the Core and Fuel Profit-
able Growth*, says his research shows that the average "shelf life"
of business strategies has shrunk by roughly 50% over the past 15
years. The reason? "Globalization. Capital moves faster, and dif-
ferentiations are harder to defend," he says. "But companies that
are able to extend their franchise are able to achieve a new surge
in growth, which is one of the hardest acts in business."

Zook points to United Parcel Service Inc., which clocked in at
No. 33 in this year's rankings. With its basic business of delivering
packages turning into a mature business growing in the mid-
single digits, Atlanta-based UPS conducted extensive customer
research that revealed that many of its corporate shippers were
looking to offload the chore of managing their supply chains,
which would free them to focus on their core businesses. So
UPS went on an investment binge that today enables it to do ev-

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everything from managing warehouses for customers to helping run clients' entire global transportation network. For some customers, it even handles repairs: If you own a Toshiba Corp. laptop that needs fixing, Toshiba provides an 800 number that's actually manned by UPS, which dispatches a UPS driver to pick up the broken laptop for shipping to a UPS warehouse in Louisville, where UPS-trained technicians fix it before shipping it back, via UPS, of course. That diversification has enabled Toshiba to focus on its core business of designing and building computers, and helped UPS boost its sales an average 13% over each of the past three years. "UPS is not just a transportation company anymore. It's an information technology company focusing on transportation," says David Simchi-Levi, a professor and supply-chain expert at Massachusetts Institute of Technology. "There is going to be a lot of demand for such services, and UPS is perfectly positioned to deliver them efficiently."

STAYING FRESH

INEVITABLY, POWERFUL macroeconomic forces helped shape this year's BW 50 rankings. The Class of 2007 includes a number of energy companies that are basking in the sharp rise in oil prices over the past two years: Sunoco (No. 6), EOG Resources (No. 20), Valero Energy (No. 36), and XTO Energy (No. 49). And the housing boom taking place in recent years helped give a lift to a number of companies on the list, including Bed Bath & Beyond (No. 15), Sherwin-Williams (No. 22), and even Moody's (No. 29), which has enjoyed a booming business providing credit ratings for the trillions of dollars of mortgage-backed securities issued by Wall Street. (To avoid perceptions of favoritism, we excluded *BusinessWeek's* parent, The McGraw-Hill Companies, from the rankings, even though its performance would have earned it a spot in the top 50.)

If there's one common trait among these companies, it's the degree to which these companies don't take their success for granted. Truth is, many work hard to anticipate and head off po-

Sector Snapshot

The BW 50 rewards companies that outperform industry peers. But weak companies in strong sectors, of course, still sometimes post better numbers than strong companies in weak sectors. Here's a look at how each of the 10 sectors in the S&P 500 have performed annually over the past three years.*

SECTOR	MEDIAN AVERAGE RETURN ON INVESTMENT**	MEDIAN AVERAGE ANNUAL SALES GROWTH
CONSUMER STAPLES	24.3%	6.1%
ENERGY	23.3	26.0
HEALTH CARE	22.1	10.1
FINANCIALS	21.0	13.9
INDUSTRIALS	19.2	10.7
CONSUMER DISCRETIONARY	19.0	9.1
MATERIALS	18.1	9.3
INFORMATION TECHNOLOGY	15.1	12.8
TELECOMMUNICATION SERVICES	11.0	1.3
UTILITIES	10.4	7.5

Data: Standard & Poor's Compustat

*Figures exclude companies that were removed from consideration because of incomplete data and other reasons

**Median return on shareholder equity for the financial sector.

tential problems well before outside are even aware of these looming challenges. That's the case at Starbucks Corp. (No. 28, its fourth consecutive appearance), where founder and Chairman Howard Schultz recently sent other executives a memo—leaked by an employee to a Starbucks blog questioning whether such labor-saving initiatives as having *baristas* use automatic espresso machines was leading to what he called the “commodification” of the Starbucks experience.

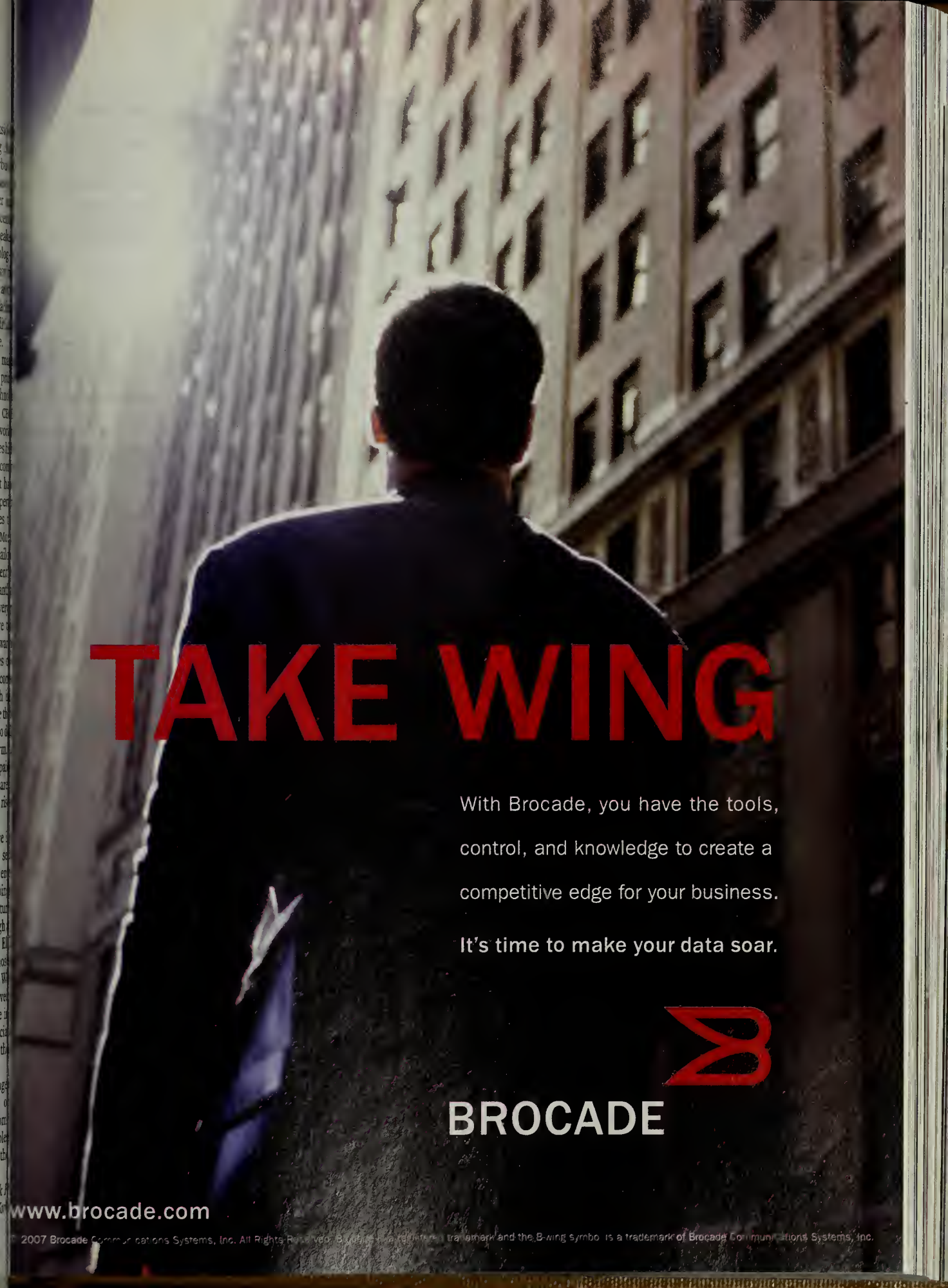
Fearful that the tech services market will one day revolve around price and price alone, Cognizant Technology Solutions Corp. (No. 12) CEO Francisco D'Souza is feverishly working to ensure that he differentiates his services from what is offered by competitors. To that end, Cognizant has begun hiring MBAs who are experienced in banking and other industries work with customers such as JPMorgan Chase & Co. onsite to help tailor Cognizant's service to each client's specific business. And it is constantly adding higher-value services—everything from testing new software implementing the sprawling software platforms developed by the likes of SAP and Oracle. “We have to be constantly focused on staying fresh in the eyes of our customers because the [info-tech service] companies who are nothing won't be there long term,” says D'Souza. That strategy has paid off in spades for Cognizant shareholders, who have seen shares rise 57% over the past year.

What BW 50 companies share is an unshakable passion for excellence. This year we've selected a handful of our star performers to profile: Allegheny Technologies Inc., a producer of specialty metals that's doing a brisk business selling to the resurgent aircraft manufacturers; Oracle, which has expanded its software suite through a flurry of acquisitions; and commercial broker CB Richard Ellis Group, which is helping real estate developers fill all those gleaming new office towers going up around the globe. We also took a look at Lehman Brothers Inc., which has moved far beyond its roots as a bond dealer to become a force in M&A, and Stryker, whose artificial hips and knees have become the rage among aging boomers.

To round out this year's package we've included brief snapshots of each of the BusinessWeek 50 companies as well as statistical tables that provide rankings for each of the year's best performers. ■

—With Michael Mandel, Frederick J. Jespersen, and David Henry in New York

» One trait in common:
None of these 50 takes
success for granted



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27

Oracle has won 30 new retail customers in the past 12 months

Oracle

CEO Larry Ellison engineered a string of acquisitions that have given a boost to the software giant's revenues. Now he must prove he can manage a bigger, more complex company. **by Steve Hamm**

SAY WHAT YOU WILL ABOUT LAWRENCE J. ELLISON, Oracle Corp.'s often controversial chief executive, but he's not afraid to change his mind. For most of the software giant's 30-year history, co-founder Ellison believed that acquisitions were a stupid way to expand a software company. His thinking abruptly changed three years ago when he decided the \$150 billion corporate-software industry was mature and needed consolidation. Since then, Oracle has spent nearly \$24 billion to buy 30 companies, including the just-announced \$3.3 billion takeover of Hyperion Solutions Corp.

That string of acquisitions helped boost Oracle's annual revenues by more than 50%, to an estimated \$17.7 billion, for the fiscal year ending in May. But it's too early to tell if Ellison's gamble will be a major success. By spending nearly as much on M&A in three years as Oracle has made in profits over three decades, Ellison has put the company on a more equal footing, in size, with rivals SAP and IBM. Now, Ellison has to prove he can manage this big, complex company. Among his chief challenges: Combine the best of the technologies from many of his acquisitions into an über-suite of applications, called Fusion. "We like Or-

acle's strategy, but it will take years to tell if all this spending is going to pay off," says analyst Brent Thill of Citigroup.

Ellison's strategy is more nuanced than it may appear. A lot of excitement was generated by Oracle's buyout of PeopleSoft and Siebel Systems, amounting to \$16 billion combined. The two were Oracle's rivals in the

market for corporate applications such as accounting, HR management, and customer relationship management. Oracle collects huge annual maintenance fees from PeopleSoft and Siebel customers, which analysts figure will help it achieve 20%-plus growth in annual earnings per share. But what about revenue growth?

That's where the other acquisitions come in. The purchase of Hyperion, which makes business intelligence software, fills one gap in Oracle's product portfolio. Other buys were designed to help the company expand rapidly in corporate software markets that are still immature. But Oracle's largest revenue opportunity lies in providing software designed for specific industries. It has gradually created soup-to-nuts product offerings for five segments: retail, financial services, utilities, communication, and government. Until recently most of those types of organizations designed their own programs to run core operations. Now many are switching to off-the-shelf software applications that are designed specifically for their needs and that can be customized to fit even better.

Oracle has used acquisitions to quickly build expertise in those areas. Consider its strategy in going after the market for packaged retailing software—programs designed to appeal to a large number of retailers rather than being written for specific customers. The

business is expected to grow from \$7.4 billion last year to \$9.3 billion in 2009, according to analyst Rob Garf of AMR Research Inc. Oracle snatched retail software market leader Retek Inc. out from under SAP's nose two years ago, then snapped up two smaller companies, ProfitLogic and 360Commerce, to pull together a suite of retailing software.

That helped Oracle win 30 new retail customers in the past 12 months, including Wal-Mart, Nordstrom, and Perry Ellis International. Last quarter, Oracle's sales of retailing software tripled, albeit from a relatively small base. "We have a tremendous amount

of momentum now," says Duncan B. Angove, a Retek veteran who now runs Oracle's retail applications business.

Oracle's win at Perry Ellis shows why its retail business is catching fire. The Miami-based fashion house was hoping to replace antiquated software by selecting so-called best-of-breed products from a handful of suppliers. After Oracle bought Retek, ProfitLogic, and 360Commerce, Perry Ellis could fulfill all of its software needs from one source. "They had the product with all the solutions," says Luis Paez, chief information officer at Perry Ellis, who expects to save more than \$20 million a year with just-in-time inventory controls, improved

merchandising, and software that helps stores set the optimal price at which to sell merchandise, thanks, in part, to Oracle's software.

SAP is no pushover, though. The two software giants are like Sumo wrestlers struggling to gain advantage, and SAP is way ahead in fashioning software packages for individual industries. It has 26 to Oracle's 5—which helps explain why it captured 21.9% of the corporate applications market last year to Oracle's 11.8%, according to AMR. Oracle has signaled that it will buy more companies to keep revenues and market share growing. But that puts ever more pressure on Ellison to make his huge investments pay off. ■

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Stryker

Profits at the artificial joint maker are soaring as aging boomers refuse to be sidelined by wear and tear. Credit a CEO who has galvanized both the sales force and R&D. **by Arlene Weintraub**

IN 2005, STEPHEN P. MACMILLAN was placed in an unenviable position at Stryker Corp. He had to replace John Brown, who, during a stellar 27-year run as CEO, turned Stryker into one of the leading makers of replacement joints, such as shoulders, knees, and hips. To ease Wall Street's fears about his retirement, Brown took a measured approach to the succession process, first bringing MacMillan in as chief operating officer in 2003. Brown and MacMillan worked side by side for more than a year to ease the transition—and still investors were skittish. “Clearly there were questions about whether the company could continue to do well,” MacMillan says.

The Street is over its jitters now. In 2006, Stryker's net profit soared 21%, to \$778 million, on sales that jumped 11%, to \$5.4 billion. The Kalamazoo (Mich.) company—which also sells high-tech tools such as imaging systems to help surgeons reconstruct jaws, spines, and other body parts—has returned 29% to shareholders during MacMillan's tenure. That performance far outpaced the Standard & Poor's 500 Health Care Index.

MacMillan has some strong demographic winds at his back. As 77 million baby boomers sail into their golden years, their joints are beginning to wear out. And unlike their parents, they're unwilling to hang up their skis and adopt sedentary lifestyles eased by ice packs and ibuprofen. “They don't want to be told to stop doing their activities,” says MacMillan, 43. “They want to get [new joints] early in life

rather than sitting on the sidelines.”

When MacMillan became CEO, however, Stryker wasn't taking full advantage of this opportunity. Growth in sales of knees, hips, and other joints, which account for about 60% of Stryker's business, was down several percentage points

from the torrid 23% growth in 2003. At the time, there were relatively few innovations in the pipeline.

MacMillan acted swiftly. Within days of taking the helm he replaced the chief of the orthopedics division with someone he trusted to motivate the sales force. At the same time, to stoke the production pipeline, he hiked spending on research and development. In 2006, R&D jumped 14%, to \$324 million. That's 6% of sales up from 4.8% in 2002.

The changes are starting to pay off in products such as Stryker's Triathlon knee system. This compact implant was introduced in late 2004, but it didn't catch on as quickly as MacMillan had hoped. So Stryker revamped the marketing strategy, instructing salespeople to pitch the knee as an ideal implant for women whose knees are typically smaller, and who might be attracted by the idea of custom fit. The message resonated with patients such as Judy Webster, who had both her knees replaced with Triathlon last year. “Women come in different shapes and sizes than men,” says

Webster, 59, whose knees had been worn down by rheumatoid arthritis. She is now virtually free of pain, she says, and hopes to restart her career as a special education teacher. Stryker doesn't break out sales of individual products, but MacMillan says the strong response to Triathlon helped push Stryker's U.S. knee sales up 16% in 2006.

Triathlon is part of a push at Stryker to carve out new market niches in orthopedics. The company has recently entered the field of hip resurfacing,

a new technique that doctors use to reshape and cap part of the hip rather than replacing it outright. Although orthopedic surgeons are debating the effectiveness of the procedure, MacMillan defends it as an important new choice for patients. “Some younger patients don't want to go through the agony of a full hip replacement,” he says. Stryker launched its own hip resurfacing device overseas in January. It hopes to launch a second product in the U.S. this year, developed by Corin Group, pending a verdict from the Food & Drug Administration.

All this slicing and dicing of the ortho-



3I

Sales of knees such as Triathlon (left) are up after a change in strategy

pedic surgery market hasn't met with uniform approval, however. Devices such as the Triathlon are more expensive than older technologies, prompting some protest from the hospitals that buy them. Dr. Kevin J. Bozic, assistant professor of orthopedic surgery and health policy at the University of California at San Francisco, says his hospital has shied away from gender-specific knees and other newfangled implants. He estimates that the overall

Doubts about the value of new models worry some Wall Street analysts

cost of hip and knee implants has doubled over the past dozen years. "We don't think the incremental change in the technology justifies the cost," he says. Such reactions worry some Wall Street analysts because downward pressure on prices could stall Stryker's momentum.

"There is push-back already," says Michael N. Weinstein, an analyst at JPMorgan Securities Inc.

Stryker is spreading its bets. Last year it paid \$50 million for Sightline Technologies Ltd. in Haifa, Israel, which

makes flexible endoscopes, tiny cameras for procedures such as colonoscopies. Weinstein estimates that Stryker will generate \$800 million in free cash flow this year, and MacMillan says he'll use some of Stryker's war chest to make other small acquisitions. Increasing the breadth of the product selection will help Stryker win the confidence of price-wary hospitals. "They can say: 'We'll provide all your hips and knees, and we can set up your operating room cameras,'" says Jeffrey D. Johnson, an analyst for Robert W. Baird & Co. "That's a powerful negotiating stance." And it's a more comfortable position for MacMillan, as he strives to preserve the legacy he was handed. ■

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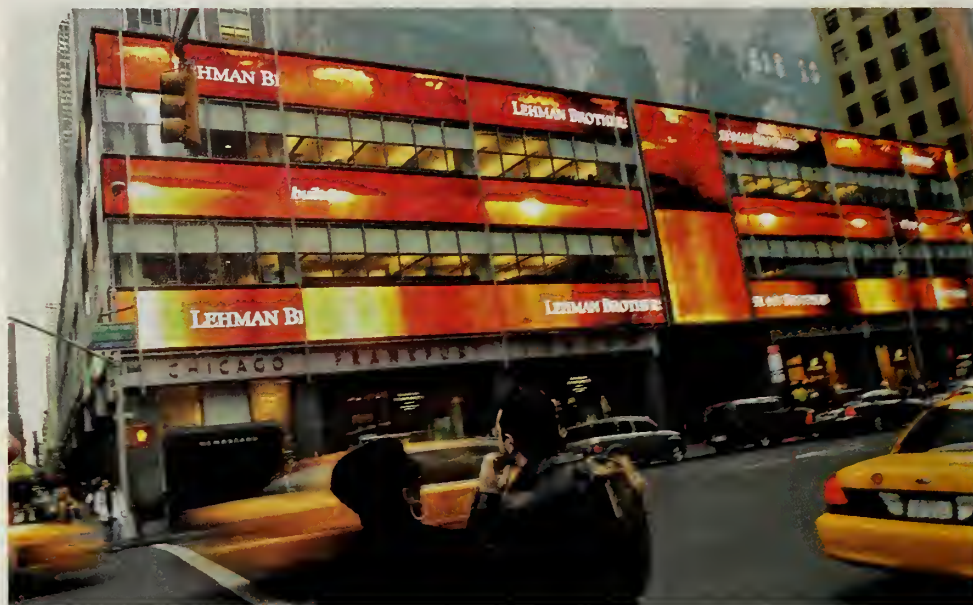
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BEST PERFORMERS



23

New York HQ:
Lehman defied
predictions of
a takeover

Recently Lehman landed another big job, helping Altria Group Inc. orchestrate the spin-off of its remaining 89% stake in Kraft Foods Inc., set for Mar. 30. In mergers and acquisitions, Lehman ranked as the No. 5 adviser, based on the value of its deals, landing 23% of deals announced worldwide so far this year, versus 6.5% in 2001, according to Thomson Financial.

Lehman

It's a lead underwriter of the first U.S. hedge-fund IPO—and has a stake in what could be the largest private-equity deal ever. The house that bonds built has come a long way. **by Emily Thornton**

WHEN LEHMAN BROTHERS Holdings Co. was spun off from American Express Inc. in 1994, it was little more than a bond trading operation, hobbled after a failed merger with AmEx. Back then, few would have predicted Lehman would become one of Wall Street's most prominent players. Now it has a hand in all the hottest areas of finance, from private equity to mergers, while remaining a leading innovator in bonds. This diversification helped Lehman nab the No. 23 spot on the BW50.

Lehman's rise comes under the leadership of its tough-as-nails CEO Richard S. Fuld Jr. In the era of megamergers such as those that formed Citigroup and JPMorgan Chase & Co., Fuld decided to go it alone, defying those who predicted

Lehman would be gobbled up. Fuld continued to be dogged by doubters as he ramped up its investment banking, asset management, and other nonbond businesses, only helping to reinforce an us-against-the-world mentality at Lehman. It's this fiercely independent spirit, not unlike that of BW50 member Goldman Sachs & Co. (No. 9), that has proved key. While bigger competitors have stumbled, lean-and-mean Lehman has quadrupled its net income, to \$4 billion, since 2002.

Lehman is practically unrecognizable from its early days. Bonds are no longer the sole growth engine. On Mar. 13, Lehman bought a stake in hedge-fund leader D.E. Shaw. It's also a go-to adviser for investment banking deals, as one of two lead underwriters of Fortress Investment Group—the first initial public offering of a hedge fund in the U.S.

Lehman is getting in on more high-profile private equity action, as well. Case in point: It is one of four investment banks hoping to cash in on the largest private equity deal ever as an investor in the \$4-billion buyout of energy outfit TXU Corp.

Even its core bond business continues to evolve. At Lehman, it's no longer just about U.S. bonds but all matter of fixed income products across the globe, including mortgage-backed securities and collateralized debt obligations. At the same time, Lehman has successfully ridden (not to mention fueled) the meteoric rise in global demand for bonds—from \$16 trillion in 2000 to \$33 trillion.

Yet the stock is not getting much respect. At around 76 it's up 20% since the beginning of 2006. That's better than the 13% gain posted by Standard & Poor's 500 Financials Index, but it's far cry from the 59% jump of Goldman. One worry is that Lehman's residential mortgage business has softened along with the housing market. It's not dirt but "I'm not looking to buy," says Antonio V. Schutz, a manager at Burnham Financial Services Fund. Lehman declined comment, citing a quiet period before reporting earnings on Mar. 14.

Still, Lehman has a history of proving skeptics wrong. It pulled through false rumors of near-insolvency triggered by the collapse of hedge fund Long-Term Capital Management in 1998. And the terrorist attacks on September 11, 2001, which rendered its former headquarters uninhabitable, only strengthened Lehman's resolve. Once again, Fuld is preparing to silence the naysayers. ■



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TRAVELERS

Allegheny Tech

The specialty metals company has seen a dramatic reversal of fortune since 2003, thanks to demand from hot industries such as aerospace, oil and gas, and nuclear power. **by Brian Hindo**

THE FIRST THING ALLEGHENY Technologies Inc. would like you to know is that it's not a steel company. It made around 445,000 tons of steel last year, its stock is a component in the Dow Jones Steel Index, and it often trades in sympathy with the likes of U.S. Steel Corp. (No. 42) and Nucor Corp. (No. 4). But what made Allegheny the best-performing stock in all the Standard & Poor's 500-stock index last year wasn't steel but its slate of specialty metals—in particular, titanium, which is being gobbled up in huge quantities by the booming aerospace sector.

Allegheny's titanium—and its nickel and tantalum, for that matter—are key components in jet engines. Boeing Co. is also using titanium alloys in the body of its new 787 Dreamliner. All this has sparked a huge reversal of fortune for Allegheny. As recently as 2003 the company was deeply in the red, with its main stainless steel business “hemorrhaging money,” according to Chief Executive L. Patrick Hassey, who joined up late that year. Now aerospace makes up a third of Allegheny's sales and is the main reason its stock returned a gaudy 153% in 2006 as it leapt from \$5 billion to \$10 billion in market value.

The stars have lined up pretty well during Allegheny's astronomical ascent. Nearly all of Allegheny's end markets are clicking. Its stainless steel alloys are used in ethanol storage tanks and elsewhere in the oil and gas business. Exotic metals such as zirconium and hafnium are used in nuclear power plants. And Allegheny has a growing presence in medical markets with metals such as niobium-titanium alloys, which are used in magnetic resonance imaging (MRI) machines. This



pitch-perfect portfolio has propelled it No. 26 on the BusinessWeek 50 list. It has fans up and down Wall Street—and a one sell rating.

Such unanimity might make skeptical investors want to head for the exits. But the bulls argue that the advance in share price (shares recently traded near \$100, up from \$26 two years ago) has been underpinned by steady earnings growth. Shares trade at 18 times earnings, only slightly higher than they traded in early 2006. The company posted net income of \$572 million in 2006, up 59% from 2005, on \$4 billion in revenue. Citigroup analyst John Hill expects earnings to grow 33% in 2007 and 17% in 2008.

The company is confident enough that it's laying out \$500 million this year to continue expanding the capacity of its plants, bringing total capital investment to \$830 million since 2005. “Initially seemed aggressive,” says Deutsche Bank analyst David Martin. “But I think they're making the right moves.” Hassey points to a five-year, \$2 billion deal with GE Aviation and a nine-year, \$2.5 billion deal with Boeing. Allegheny's outlay will increase its ability to produce titanium—ranging from a basic form of the metal, called sponge, to finished products such as titanium bars.

26

Allegheny's 153% return in 2006 topped the S&P 500

Good signs, of course. But as the bigger steelmakers have learned well, any metals company has to keep an eye on China, which has the potential to bring capacity in a hurry. That's nettlesome

for Allegheny in particular, whose nickel products don't add up to a tremendous amount of volume, argues Prudential Equity Group analyst John C. Tumazos. “It doesn't take too big a furnace to be built to shift these specialty markets into oversupply,” he wrote in a recent report. His price target on Allegheny is \$60, a valuation in accord with the more traditionally cyclical steel companies. For his part, Hassey says that Allegheny's products are so high grade that they can't easily be copied.

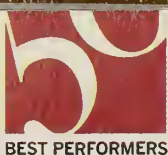
As momentum investors have piled on for the ride, Allegheny has taken note. “I think the market considers me a home-run hitter today,” Hassey says. “So they're expecting more home runs.” Allegheny clearly has taken full advantage of its exposure to red-hot industries. When it comes to being lucky or being good, why split hairs? ■

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BEST PERFORMERS

I6

A broker at work in a CBRE rental space in New York



CB Richard Ellis

A healthy global economy and a boom in commercial sales are helping the world's largest real estate services company thrive as the market grows more complex. **by Christopher Palmeri**

THE EL SEGUNDO (CALIF.) headquarters of CB Richard Ellis Group Inc. is moving for the fourth time in 10 years. Normally the company is chasing cheaper rents. This time, Chief Executive Brett White and the eight others in the executive suite want shorter commutes; White's was an hour and 40 minutes on a recent Monday morning. They're going 15 miles north to Westwood. "We're doing exactly what we tell clients not to do," he says with a wry smile. "We're moving to higher-priced space when times are good."

Times are indeed good for the world's largest commercial real estate services company. With more than 300 offices, CB Richard Ellis leases, sells, operates, and appraises commercial properties; manages real estate investment portfolios, supervises construction, and originates and brokers mortgages. (The CB harks back to Coldwell Banker, but it hasn't been connected to the residential brokerage since 1989.) Since going public in 2004, revenues have climbed more than

70%, to \$4 billion, and earnings have quintupled, to \$318 million.

CB Richard Ellis is benefiting from a strong global economy and a relatively modest pace of construction—particularly for high-end office space. Companies are expanding globally and outsourcing real estate management to specialists. That's led to CB Richard Ellis handling some huge deals lately. Last year it represented owner MetLife Inc. when it transacted the largest sale ever of a single piece of real estate: that of Manhattan's Stuyvesant Town apartments to Tishman Speyer Properties for \$5.4 billion.

Another megatrend at work is money managers' continued fascination with commercial properties, even as residential real estate goes cold. In the past decade institutional investment in U.S. real estate has climbed from \$250 billion to \$600 billion. Says Geoffrey Dohrmann, president of Institutional Real Estate Inc., a market research firm: "Just as institutions became the dominant force in the equity and bond markets, they will be in real estate, too."

The company has made dozens of acquisitions since beginning to diversify in 1991, most recently the \$2.2 billion purchase of Dallas-based real estate services firm Trammell Crow Co. last year. That brought a blue-chip roster of corporate clients as well as a business that develops buildings for clients.

Does CBRE have a finger in too many pies? Playing multiple roles is common in real estate, but some firms avoid it. Staubach Co., founded by football great Roger Staubach, accepts only tenants as clients, on the theory that representing both landlords and tenants is a conflict of interest. White says that CBRE's success shows that it can handle conflict. As evidence he points to a unit that invests institutions' money in commercial real estate. The unit's managers can own stock in CB Richard Ellis and the compensation is based solely on client returns. They choose whomever they want as leasing brokers. "About 40% of the time we're embarrassed because the hired a competitor," White says.

Its reach, while complicating life, may be the company's strongest selling point. "When you're selling computers or cars on a global basis, you have to be everywhere," says client Eugene Bauchner, head of real estate in the Americas for the advertising firm WPP Group. "Some markets where it's very tight, they create space where none exists. There aren't many companies that can do that." ■

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The Ranking

Luxury goods, Web wonders, energy giants, biotech's best—the big winners found better ways to relate to their customers, or changed the rules of their industries outright

GOOGLE

Much of the media industry, from Viacom to book publishers, is firing away at Google. They're angry that the search giant is pushing the boundaries of copyright law—and, worse, that it's stealing a march on them in online advertising. With \$10.6 billion in 2006 revenues, up 67% for the year, Google commands at least 31% of all Web ad revenues. That feat is nearly all thanks to those small text ads that run alongside search results and on partner sites. Now, CEO Eric Schmidt is pushing into print ads through deals with newspapers, and into radio through its 2005 acquisition of dMarc, a company that connects advertisers with

radio stations. Those initiatives haven't yet taken off, but Google's torrid hiring pace—its staff nearly doubled last year, to 10,000—leaves no doubt about its commitment. This year it's even taking a shot at Microsoft with online services aimed squarely at the software giant's stronghold: office software.

INDUSTRY
Internet Software & Services
SALES
\$10.6 billion
NET INCOME
\$3.1 billion



Schmidt is pushing in ads and radio and even into Micros

I

2

COACH

INDUSTRY
Apparel, Accessories &
Luxury Goods

SALES
\$2.4 billion

NET INCOME
\$579.6 million

3

GILEAD SCIENCES

INDUSTRY
Biotechnology

SALES
\$3 billion

NET INCOME*
\$1.2 billion

» Women everywhere know a good bag can be a better investment than a designer dress or power suit. Coach is successfully cashing in on this fashion wisdom, marketing bags with names like Hamptons Weekend to style-conscious shoppers from urban fashionistas to upscale suburban moms. It's also extending the brand to secondary categories, including jewelry, launched just last year. In the U.S. and overseas, particularly in Japan, Coach has grabbed sales from such rivals as jeweler Tiffany and from other luxury-goods segments, too. But as it expands its products and opens new stores, it risks suffering from a potential curse for any name: overexposure. **CEO LEW FRANKFORT** insists the brand is "vibrant," adding that "our opportunities, notably in our home market, are boundless." Still, when preteens in Peoria flaunt a Coach product, the big-city grown-ups might just flee.

» It wasn't easy for Gilead's scientists to combine three HIV drugs into one pill. But once they did, the payoff was swift and clear as patients grabbed the opportunity to cut down on the piles of medications they have to take each day. The product, called Atripla, hit the market in July, 2006, and brought in sales of \$205.7 million through December—a strong launch for a drug that analysts estimate could become a \$2 billion-a-year hit. Gilead was already a powerhouse among providers of HIV treatments. Its other products to fight the virus drove sales up an average 51.8% a year for the past three years. In October, **CEO JOHN MARTIN** made a big push to diversify beyond HIV treatments, paying \$2.5 billion for biotech company Myogen. That company's experimental drug to treat a rare form of hypertension could be approved by the FDA later this year. Gilead is also working on new drugs to treat cystic fibrosis and hepatitis.

*Inclusion of a one-time R&D charge and other special items would result in a net loss of \$1.2 billion.

4

NUCOR

INDUSTRY
Steel

SALES
\$14.8 billion

NET INCOME
\$1.8 billion

» Nucor has long been known as the best operator in the steel business, and is especially famous for its enlightened work-force relations and commitment to new technologies. It pays line workers according to their productivity and listens to, and implements, their ideas to make the process better. Responsibility is pushed as close to the front line as possible. For most of its history, Nucor only grew organically, but under **CEO DANIEL DIMICCO** the company has found it's often cheaper to buy than build. Now executives export the Nucor way to a series of acquired plants: In the past year, it has bought Connecticut Steel, Harris Steel Group, and the assets of Verco Manufacturing. Acquisitions such as Verco, a maker of steel floors and roof decks, help broaden Nucor's product line and support its migration into higher-margin products.

5

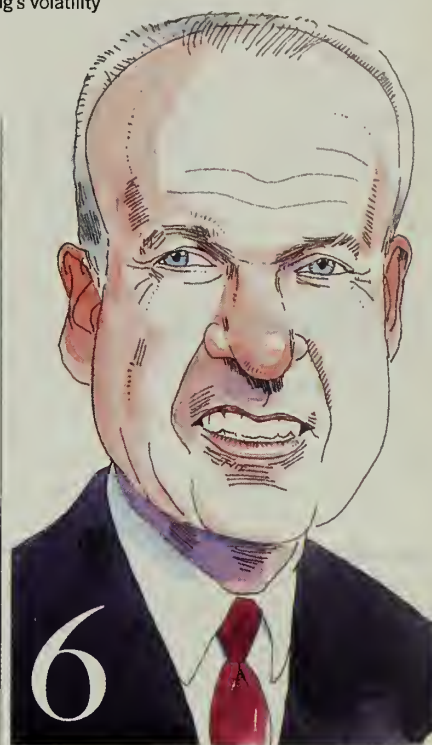
QUESTAR

INDUSTRY
Gas Utilities

SALES
\$2.8 billion

NET INCOME
\$444.1 million

» Questar traces its roots to a natural gas discovery in Wyoming back in 1922. Today, the Salt Lake City outfit is one of the nation's top-performing energy companies. The reason for its success? Focus. Under **CEO KEITH RATTIE**, the company has rapidly added new natural gas reserves at low cost by staying close to its Rocky Mountain beginnings. Questar combs over old fields at greater depths than ever by using the latest drilling technologies. Its biggest natural gas field, Pinedale, is still just 150 miles from that 1922 strike in southeastern Wyoming. The company reaps most of its revenue from exploration, but also owns gas pipelines and a natural gas utility serving more than 800,000 customers in Utah. Revenue from those other businesses provide a nice cushion to help offset the ebb and flow of natural gas prices—and keep Questar's earnings and dividends flowing.



SUNOCO

» **A**mid a flurry of mergers and investment in refining, conservatively run Sunoco has gotten record results while sticking largely to its knitting. Since 2003 revenues have more than doubled, and net income has more than tripled. The refiner processes mostly light, sweet crude oil into gasoline, heating oil, kerosene, and other products.

While the light sweet stuff is costlier to buy than heavy, sour crude, it's less expensive to process. With **CEO John Drosdick** at the helm since 1996, Sunoco stands out among its peers for holding on to big stakes in gas stations, coke production, and other chemical-processing businesses. They're considered to be something of a cushion from the volatility of the refining business.

INDUSTRY
Energy

SALES
\$36 billion

NET INCOME
\$979 million

7

VERIZON COMMUNICATIONS

INDUSTRY
Telecommunications

SALES
\$88.1 billion

NET INCOME
\$5.5 billion

» Verizon had a banner year in 2006. The telecom provider signed up more wireless customers than any other operator, its business unit began to grow for the first time in years, and it launched its risky yet bold TV service. The moves are part of **CEO IVAN SEIDENBERG'S** plan to transform Verizon into a diversified giant offering voice, Internet tie-ups, and wireless and TV services. It all seems to be jelling: Shares are up 24%, their largest gain since 1999. Now Verizon must sign up more users in new markets such as video, broadband, and wireless data in the face of stiff cable competition. But don't look for Seidenberg to put that expansion on hold.

8

COLGATE-PALMOLIVE

INDUSTRY
Consumer Staples

SALES
\$12.2 billion

NET INCOME
\$1.4 billion

» Sometime this year, **REUBEN MARK**, CEO of Colgate-Palmolive since 1984, will step down and be succeeded by Englishman Ian Cook. Mark, famous for consistent execution, rallied his well-trained global management team to pull Colgate out of a rough patch a few years back by redoubling the focus on its highest-margin soap, pet food, and oral care products. Competing against Procter & Gamble, Colgate hasn't always seemed innovative enough to keep up. But this year's crop of new products, which include Colgate Max Fresh Kiss Me Mint toothpaste, has done fine, helped by a big boost in worldwide ad spending.

9

GOLDMAN SACHS GROUP

INDUSTRY
Financials

SALES
\$69.4 billion

NET INCOME
\$9.5 billion

» Between its trading prowess and dealmaking savvy, Goldman Sachs sets the bar for Wall Street. Last year its trading and investing revenues rose 52%, to \$25.6 billion, while banking chipped in \$5.6 billion, up 53%. Little wonder that **CEO LLOYD BLANKFEIN**, a master trader, took the helm when Henry Paulson left to become U.S. Treasury Secretary. Even as the firm paid rich bonuses, earnings leapt 70%. But with the Street and markets like China suffering, Goldman will be hard-pressed. Its response: diversify geographically and by product mix while investing alongside clients. Yet analysts are skeptical. Goldman's stock has slipped to 200, from a high this year of 223.

10

PACCAR

INDUSTRY
Industrials

SALES
\$16.5 billion

NET INCOME
\$1.5 billion

» The rush to buy trucks before the EPA's new 2007 limits on diesel engines explains, in large part, how heavy-duty truck leader Paccar motored to a record profit in 2006 on all-time high sales. But Paccar and **CEO MARK PIGOTT** deserve credit, too. The company's custom-built Kenworth and Peterbilt trucks are a favorite among drivers, helping it begin 2007 with a \$2.7 billion backlog. But with so many new rigs on the road, analysts expect profits to slide 26% in 2007, the first reversal since 2001. Profits could rise again by 2008: With the takeover of two European truckmakers, Paccar now sells more overseas than at home—and those markets are growing.

11

AMAZON.COM

INDUSTRY
Internet Retail

SALES
\$10.7 billion

NET INCOME
\$190 million

» Amazon.com has outgrown the perception, created during the dot-com crash, that it could never make money, but it still challenges the faith of its investors. For the past two years, the online retailer has invested heavily in new technology, wiping out some of the profit gains it displayed since first moving into the black in 2003. In 2006, **CEO JEFFREY BEZOS** plunged Amazon into digital media with an online movie service called Amazon Unbox. Bidding to become a 21st century digital utility, it is also moving into new markets that have nothing to do with retailing, such as paid services that allow other companies to tap into Amazon's vast data storage and computing resources. But those investments have yet to pay off. As a result, the online retailer's profits fell by half last year despite surprisingly strong sales of \$10.7 billion, up 26% over the year before. Investors will have to be patient a while longer.

12

COGNIZANT TECHNOLOGY SOLUTIONS

INDUSTRY
Information Technology

SALES
\$1.4 billion

NET INCOME
\$232.8 million

» Even in the fast-growing outsourcing industry, Cognizant is a standout. Propelled by the increased outsourcing of health-care data processing and by a growing number of European clients, Cognizant's 2006 sales jumped 61%. Its bread and butter, though, remains managing financial and information-tech services for U.S. clients; companies such as Wells Fargo, Citigroup, and Aetna account for 86% of its sales. To keep growth humming, **CEO FRANCISCO D'SOUZA** plans to hew to the company's policy of investing aggressively in operations and staff, adding 16,000 workers, mostly in India and China. And he plans to spend \$200 million on more office space and infrastructure in India, where Cognizant has 70% of its operations. The outlay comes at the cost of margins lower than Indian rivals Wipro and Infosys Technologies, but so far these bets have paid off in growth.

» A telecom giant launches into TV, a truckmaker roars into Europe

Jung is pulling Avon out of a tailspin



AVON PRODUCTS

Over the past 18 months, CEO Andrea Jung has had to make some tough choices at Avon. After six years of racking up 10%-plus annual revenue growth, the consumer products giant stumbled badly in 2005 as problems cropped up around the globe. Developing markets such as Central Europe that had been key to Avon's growth hit road blocks, and sales in the U.S. and Mexico stalled. Concluding that Avon needed a true makeover, Jung cut 7 of her 15 levels of management and instituted a more rigorous analytical approach to marketing and other business decisions. Manufacturing and marketing moves once made by country managers are now largely centralized with a more efficient global approach. To offset the cutbacks, Jung has invested heavily in advertising (up 83% in 2006) and improved compensation for some of her direct-sales representatives. The company, which already collects more than 70% of its revenues outside of the U.S., has continued its focus on emerging markets, recruiting 399,000 new salespeople in China in less than a year.

INDUSTRY
Consumer Staples
SALES
\$8.8 billion
NET INCOME
\$477.6 million

I4

VARIAN MEDICAL SYSTEMS

INDUSTRY
Health Care
SALES
\$1.7 billion
NET INCOME
\$251.9 million

» Varian dominates the market for radiotherapy equipment, which is used to treat cancer. Spun off from Silicon Valley pioneer Varian Associates in 1999, the company has maintained a global market share of more than 60%, thanks to management excellence, marketing muscle, and innovation. Varian's imaging technologies let doctors increase doses of radiation to cancerous tissue by avoiding healthy cells, not just through technical innovations but by creating training programs and software to boost the technologies' acceptance by hospitals. The latest example: image-guided radiation therapy, which lets docs adjust beams for minuscule changes in tumors, and even compensate as tumors move with patients' breathing. **CEO TIM GUERTIN** says sales can hit \$3 billion within five years as Varian expands its technology to cargo-inspection gear for ports and airports.

I5

BED BATH & BEYOND

INDUSTRY
Consumer Discretionary
SALES
\$6.3 billion
NET INCOME
\$586.3 million

» Bed Bath & Beyond succeeds by deploying a straightforward strategy: build stores, watch expenses, generate cash, and build more stores. Despite a tough home-products market and higher building costs, Bed Bath opened 33 outlets in the quarter ended in November and now has 868—up from 34 at its 1992 IPO. Investors love its growth and cash-only approach, overseen by **CEO STEVEN TEMARES**, who has been ably guided by company co-founders Warren Eisenberg and Leonard Feinstein. The balance sheet boasts about \$1.1 billion in cash and no long-term debt. Investors, however, are bothered by questions about Bed Bath's accounting methods. Investigations are ongoing, but the company has stated in government filings that the equity-based charges are "not material" for its financial statements for earlier years and that it is cooperating with the SEC.

I6

CB RICHARD ELLIS GROUP

INDUSTRY
Real Estate Management & Development
SALES
\$4 billion
NET INCOME
\$318.6 million

» Need a place to hang your shingle in Shanghai? CB Richard Ellis will be happy to help. Since completing the acquisition of Trammel Crow for \$2.2 billion last December, CBRE has become the world's largest commercial real estate brokerage. **CEO BRETT WHITE** sees demand and rents continuing to climb in the world's business capitals. CBRE does more than just lease space. It also manages buildings, supervises construction, and brokers commercial loans. In addition, the company chooses real estate investments for pension funds and other institutional investors. No wonder CBRE shares are up from a split-adjusted 6 at its IPO three years ago to more than 32 recently.



BEST PERFORMERS

Chizen is boosting
Adobe's Web offerings

I7

ROBERT HALF INTERNATIONAL

INDUSTRY
Employment Services

SALES
\$4 billion

NET INCOME
\$283.2 million

» Robert Half **CEO HAROLD MESSMER** has been around long enough to know how to ride a wave. And he has surfed the tightening of labor markets like an old pro. The jobless rate for professionals has been low, especially in the company's sweet spot: placing accountants, marketing specialists, attorneys, and programmers. Messmer excels by targeting small and midsize companies. Smaller clients are less likely to seek discounts, and don't mind paying a higher price for top-caliber personnel. In 2006 most of its units grew 20% or more, and the one that places permanent accountants saw revenue jump 53%. Messmer also has pushed deeper into the international arena, breaking ground in both Germany and Spain, where the market for temp staffing is less developed than in the U.S. And he set up his temp business for the first time in Asia by taking advantage of existing office space in Robert Half units already operating there.

I8

CHICAGO MERCANTILE EXCHANGE

INDUSTRY
Specialized Finance

SALES
\$1.1 billion

NET INCOME
\$407.3 million

» With investors rushing to hedge their bets and with derivatives growing like mad, the Chicago Mercantile Exchange finds itself one of the most important bourses in the world. Revenues climbed 22% last year, as net income jumped 33%. The exchange, whose stock has surged more than 50%, to over 560 a share, since the beginning of 2006, has become the market of choice for investors who use futures contracts to speculate on—or protect themselves from—changes in interest rates, currencies, agricultural prices, and equity indexes. **CEO CRAIG DONOHUE'S** challenge: closing an \$8 billion deal for the Chicago Board of Trade, which will vault the Merc ahead of Europe's Euronext to be the global No. 1 in futures and derivatives. But first it must convince the regulators that uniting the nation's two leading futures markets is not monopolistic in a world where competitors are not across town, but around the globe.



I9

ADOBE SYSTEMS

Adobe has a long tradition of innovation, from the Postscript language that helped launch the desktop publishing craze in the 1980s to its Photoshop graphics program and the ubiquitous Acrobat software for handling PDF files on the Internet. But while other big software rivals such as Microsoft have slowed down with maturity, analysts expect Adobe's sales to grow 15% this year, thanks largely to Creative Suite 3, which will integrate tools used to create Web sites and move Net content onto mobile devices.

CEO Bruce Chizen also plans to woo Microsoft's software partners with a new technology called Apollo, which allows them to mix Web features into their PC programs.

INDUSTRY
Application Software

SALES
\$2.6 billion

NET INCOME
\$505.8 million

20

EOG RESOURCES

INDUSTRY
Energy

SALES
\$3.9 billion

NET INCOME
\$1.3 billion

» Since it was spun off from disgraced energy giant Enron in 1999, Houston-based EOG Resources has thrived by drilling for natural gas and oil. The company, led by **CEO MARK PAPA**, is a leader in high-tech methods and continues to hit it big with new wells everywhere from Texas to North Dakota. Production rose 16% overall in 2005, and 9% in 2006. And with energy prices soaring, EOG's net income doubled in 2005 from a year earlier. Warm temperatures near the end of 2006 depressed prices, contributing to a slide in fourth-quarter revenues, but net income for the year still climbed 3.6%. Exploration success and relatively low drilling costs put the company at the top of the industry in production growth per share. And the future looks like more of the same. EOG expects production—and reserves—to continue to rise by at least 9% per year.

21

SEMPRA ENERGY

INDUSTRY
Utilities

SALES
\$11.8 billion

NET INCOME
\$1.1 billion

» Sempra Energy has found gold in natural gas. Created in 1998 by the merger of the parent companies of Southern California Gas and San Diego Gas & Electric, the company both delivers natural gas and runs power plants on natural gas. To enlarge its infrastructure, Sempra is building liquefied natural gas terminals in Baja and the Gulf of Mexico as well as a 1,600-mile pipeline. In 2006, with new **CEO DONALD FELSINGER** on board, Sempra sold its remaining coal-fired plants at premium prices and wrote off money-losing investments in Argentina. Add in a strong performance by its commodity trading business, and Sempra's net income jumped 53% in 2006—the eighth year in a row of record earnings. Analysts expect that streak to continue. New supplies of natural gas will boost fees for deliveries and keep fuel costs from soaring, while the power plants' use of gas makes them less vulnerable than dirty coal plants to anticipated curbs on carbon emissions.



How many millions do I need to quit? That's a dumb question.

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BEST PERFORMERS

22

SHERWIN-WILLIAMS

INDUSTRY
Home Improvement
Retail

SALES
\$7.8 billion
NET INCOME
\$576.1 million

» For the past century, Sherwin-Williams has boasted that its paints cover the earth. That's pure hyperbole: The company has virtually no business outside the Western Hemisphere. But in the U.S. its paints unquestionably cover more walls and ceilings than anyone else's. Sherwin-Williams has been good to shareholders. As a matter of policy, the company pays out 30% of its earnings in dividends, which has resulted in 28 consecutive years of rising payouts. **CEO CHRISTOPHER CONNOR** is confident that 2007 will be No. 29. Despite a drop in housing starts and a slowdown in home remodeling, he predicts the Cleveland company will earn up to 10% more this year than its record \$576 million in 2006. How? By selling more to builders of nonresidential properties through its chain of 3,000 paint stores, and by expanding its automotive-paint operations in Latin America. With buckets of cash, Sherwin-Williams may also buy smaller paintmakers to lengthen its lead.

23

LEHMAN BROTHERS HOLDINGS

INDUSTRY
Financials

SALES
\$46.7 billion
NET INCOME
\$4 billion

» Lehman Brothers, the investment bank once known for its bond trading and internal warfare, is grabbing share in mergers advice and rapidly expanding its global reach. The new House of Lehman has deftly taken advantage of the huge demand for fixed-income securities from companies and traders, rolling out everything from securitized Japanese residential mortgages to student loans while beefing up its stable of bonds. At the same time, it's hiring more bankers to gather strength for a deal offensive. The strategy is working. Lehman is a co-investor in the largest buyout ever, the bid for TXU, and was an underwriter for the first IPO of a hedge fund, Fortress Investment Group. Now **CEO RICHARD FULD** wants to keep ramping up Lehman's investment management business, buying stakes in hedge funds like D.E. Shaw. He's also sharpening the firm's investment banking prowess overseas.



24

ROCKWELL COLLINS

The business dates back to Collins Radio, founded in 1933. Although today focused primarily on the aerospace industry, Cedar Rapids (Iowa)-based Rockwell Collins is still big in electronics. It's a leading maker of everything from missile guidance systems to in-flight entertainment for commercial airlines. **CEO Clayton Jones**, a former Air Force fighter pilot, seems to have found the right flight path in this era of

INDUSTRY
Industrials
SALES
\$4 billion
NET INCOME
\$516 million

surging Pentagon procurement budgets. Commercial and government work each made up half of Rockwell's \$3.9 billion in revenues last year. Rockwell is the U.S. Army's leading provider of handheld global positioning systems. It also supplies the cockpit instrument displays and navigation and communication systems for the new Boeing 787 Dreamliner. Jones is predicting another year of double-digit sales and earnings growth in 2007.

25

IMS HEALTH

INDUSTRY
Health Care

SALES
\$2 billion
NET INCOME
\$315.5 million

» Data on drugs and health care are the lifeblood of IMS Health. It collects information on everything from the number of prescriptions written for individual drugs to the medical histories of patients. By analyzing the data, IMS can help its 3,000 pharmaceutical, biotech, and health-care clients decide which marketing campaigns work best or which drugs to include in portfolios. It also advises pharmaceutical companies on how to launch a drug and what price to set, among other things. The need for data is growing as drugmakers lose blockbusters to generic rivals, struggle to produce new medicines, and face insurers and government buyers who want cost-effective drugs. **CEO DAVID CARLUCCI** has seen IMS's revenues rise 12% in 2005 and 2006, and sales look like they'll keep climbing.

26

ALLEGHENY TECHNOLOGIES

INDUSTRY
Materials

SALES
\$4.9 billion
NET INCOME
\$571.9 million

» Before an ailing Allegheny enticed **CEO PATRICK HASSEY** out of retirement in 2003, he had most recently run the aerospace business for aluminum giant Alcoa. So it's no mistake that, as the aerospace sector took off, Hassey made sure Allegheny seized the opportunity. Its titanium and nickel alloys are crucial materials for jet engines, and now the titanium is also being used by Boeing in its 787 Dreamliner plane. Allegheny's other specialty metals, including stainless steel and zirconium, serve such end markets as oil and gas, nuclear power, and medical technology. Sales jumped 30% in 2005 and 40% in 2006. Hassey expects an aerospace "super-cycle" to keep fueling growth, with demand propped up by new-plane orders in emerging markets and domestic fleet upgrades. He puts his money where his mouth is: Spending to expand titanium production capacity for the three years through 2007 is expected to total \$830 million.

10-Year Corporate Average Fuel Economy

**Honda Average
30.1 mpg**

**Industry Average
24.8 mpg**

The results of a higher mission.

Over the past ten years, Honda has achieved the highest average fuel economy of any automaker.* Which makes for better cars. Increased competition to create better technology. And, our ultimate goal, a cleaner environment.

*Based upon the average sales-weighted fuel consumption for 1996–2005 model year passenger car and light-truck fleets sold in the U.S., based on CAFE reports. © 2007 American Honda Motor Co., Inc. honda.com

HONDA
The Power of Dreams

27

ORACLE

INDUSTRY
Information Technology

SALES
\$16.1 billion

NET INCOME
\$3.7 billion

» Oracle CEO **LARRY ELLISON** has spent nearly \$24 billion over the past three years on 30 acquisitions, partly in an effort to match German software giant SAP's heft in the corporate applications market. That investment helped Oracle boost sales by more than 50% during the same period. Initially it didn't win the company favor with investors, who worried that melding all those companies into a smooth-running machine and coming out with an integrated suite of products was more than the software giant could handle. Those fears have eased recently—in part because Oracle boosted annual earnings per share by more than 20% and has gained share against SAP. One of the brightest spots: software packages for retailers. Sales grew more than 300% in Oracle's second fiscal quarter, though off a small base a year earlier. "Within a year," says Ellison, "we think the retail business is going to be big enough...to actually move the needle."



STARBUCKS

No food chain has grown as fast as Starbucks, and it shows no signs of slowing. Under CEO James Donald, it plans to boost earnings by 20% to 25% annually over the next three to five years and to bring its number of storefronts to 40,000 worldwide—10,000 more than McDonald's. Starbucks is conservative in how it finances its goals: Operating cash

INDUSTRY
Consumer Discretionary

SALES
\$8.2 billion

NET INCOME
\$612.3 million

flow from existing stores pays for new-store development. So far, the return on new stores has been excellent. Increasing same-store sales has been a tougher order, though, and Chairman Howard Schultz has expressed worries that moves to improve same-store sales with automatic equipment and off-brand merchandise could be turning consumers off.

Donald sees 40,000 stores in five years

29

MOODY'S

INDUSTRY
Financials

SALES
\$2 billion

NET INCOME
\$753.9 million

» It's no secret the world's corporations are on a borrowing binge. A flurry of leveraged buyouts and mergers, plus a voracious demand for mortgage-backed securities, is fueling a global surge in bond issuance. That means money in the bank for Moody's, which draws 80% of its revenue from rating bonds for corporations, government agencies, and the trusts that issue asset-backed bonds. The global appetite for corporate debt in 2006 helped bring about an 18% jump in revenue. The firm also generates 13% of its revenue from publishing research reports. Given Moody's dominance, **CEO RAYMOND MCDANIEL** clearly has his staff working in top gear. But a slowdown in credit markets could limit growth. In February, Moody's said revenue growth in 2007 may be in the low double-digits—and that was before the market for subprime bonds began to falter. Additional cracks in the bond market could complicate Moody's short-term growth story.

30

PEPSICO

INDUSTRY
Consumer Staples

SALES
\$35.1 billion

NET INCOME
\$5.6 billion

» New PepsiCo CEO **INDRA NOOYI** is keeping the \$35 billion snack-and-beverage giant on course as the company increases its global presence and focuses on healthy offerings. Along with extending the reach of such established brands as Quaker, Tropicana, and Gatorade, PepsiCo continually rolls out innovative sodas and Frito-Lay snacks, boosting the products' nutritional value while tailoring them to local tastes. The India-born Nooyi is also a proponent of corporate social responsibility, pushing the company to improve its performance on everything from recycling to water conservation. Nooyi firmly believes that such initiatives build employee loyalty and, she says, boost the bottom line. With a 28.3% total return over the last three years, PepsiCo isn't losing sight of what's important to investors, either.

31

STRYKER

INDUSTRY
Health Care

SALES
\$5.4 billion

NET INCOME
\$777.7 million

» With knees, hips, and other parts of affluent boomers bearing the wear and tear of aging, implant maker Stryker keeps the gains coming. Earnings jumped nearly 21% last year, to \$778 million, on a 11% hike in sales. Even as pressure mounts on prices in the feverishly competitive orthopedic-implant arena, Stryker is posting high single-digit annual gains in sales of replacements for everything from aging joints to reconstructions after accidents or other traumas. Its surgical gear remains a big winner, with sales up nearly 16% last year, to more than \$2 billion. Stryker's equipment is used in such areas as minimally invasive endoscopic surgery, which shows no signs of slowing. With investors upbeat, its stock is hovering in the 60 up from a low of less than 40 last summer. **CEO STEPHEN MACMILLAN'S** challenge: avoid commoditization, which Stryker plans to do by using its \$800 million in free cash to buy makers of innovative devices.

"Business is great in Ohio. And so is my life."

Nancy Kelly
Executive Vice President
Huntington National Bank

Nancy Kelly has called a lot of places home. But nowhere feels more at home to her than Ohio. As Executive Vice President, Nancy oversees the asset servicing group at Huntington National Bank, one of America's strongest regional banks. Referring to itself as a local bank with national resources, Huntington balances personal service with state-of-the-art banking products.

It's a similar balance of a pro-business environment with a fulfilling personal lifestyle that drew Nancy back to Ohio after moving away to Wisconsin, then Minnesota to explore other "opportunities." When the chance to return to Ohio arose, she was thrilled.

Nancy loves the honesty and diversity she finds in Ohio's business community, a merit-based environment that allows individuals to earn their success based on performance. Away from the office, Nancy has everything she wants close to home. An avid golfer, Nancy and her husband live comfortably in their golf course community. As a high-level executive through the week, Nancy appreciates the opportunity to recharge on the weekends, whether she's taking in the theater or just relaxing at the neighborhood pub with close friends.

For Nancy Kelly, balance is the key to success in the office and at home.

**Find your balance at
OhioMeansBusiness.com.
Or call 1-877-466-4551.**

Ohio
Build Your Business. Love Your Life.

Born in PA. Schooled in MD. Recruited to MN. And thrilled to return to OH.

Ohio is home to world-class shopping with many stores that are found only in the world's most exclusive retail centers. But Ohio also offers hundreds of quaint shops and communities where Nancy enjoys antiques and adding to the valuable collectibles that decorate her home.



Build Your Business. Love Your Life.

32

BEST BUY

INDUSTRY

Consumer Electronics

SALES

\$33.7 billion

NET INCOME

\$1.3 billion

» As electronics prices fall fast, Best Buy is bent on remaking itself as a purveyor of experiences. So rather than simply buying a TV, say, customers can rely on Best Buy's "blue shirts" to help them design home entertainment systems. The sales staff can act as personal tech *consiglieri*, handling everything from which products best meet the customers' needs, to delivery and setup, to hookups with a digital source. It all flows out of **CEO BRAD ANDERSON'S** sweeping and costly innovation program called "customer centricity." The program encourages those blue shirts on the floor to listen to customers' needs and turn what they've heard into new business ideas. Empowerment is so much in the air that this year Best Buy is launching a pilot that will enable store workers to make their own schedules. The idea takes its cues from Best Buy's corporate headquarters, a clockless office where there are no schedules, no meetings, and no rules about how and when to get work done.

33

UNITED PARCEL SERVICE

INDUSTRY

Air Freight & Logistics

SALES

\$47.5 billion

NET INCOME

\$4.2 billion

» Although its domestic package business has matured, UPS keeps delivering: Under **CEO MIKE ESKEW**, its expansion across Asia continues to pay off, with international sales growing 14% last year and now making up nearly one-fifth of overall revenues. In the U.S., a \$600 million "package flow technology" initiative, in which computers map out overnight the most efficient way for the majority of its 56,000 drivers to run their routes the next day, is helping boost productivity and cut costs. UPS estimates the program enabled its drivers to log 3 million fewer miles in November alone, even while delivering the same number of packages as the year before. Thanks to the new technology, later this year clients will be able to reroute deliveries to a new destination while they're en route, an unrivaled feature. These moves have helped UPS boost profits 45% over the past three years, even in a cutthroat business environment.



Jobs has designs on digital living rooms

APPLE

Somewhere along the line, Apple went from being Microsoft's whipping boy to becoming, in some ways, the new Microsoft. Apple sets the standard in digital music, with more than 70% of the music player market and nearly 90% of the song download business. While it still has just 5% of the PC market, Mac sales are on the rise, and the company is attacking vast new markets that have long been coveted by Microsoft. Targets include the so-called digital living room, where Apple hopes to stream Net video fare to the TV via its new Apple TV gizmo, and the mobile communications sector, where it's rolling the iPhone in hopes of replicating its iPod success. The company, which churns out an astonishing \$1 billion a quarter in cash, was cast in the unfamiliar role of bad guy numerous times in the last year—for Steve Jobs' role in the options backdating scandal and for sweatshop conditions at a contract manufacturer in China, among other things. But barring unexpected product bombs, Apple's star seems destined to rise farther still.

INDUSTRY

Computer Hardware

SALES

\$20.7 billion

NET INCOME

\$2.4 billion

35

T. ROWE PRICE GROUP

INDUSTRY

Financials

SALES

\$1.8

NET INCOME

\$529.6 million

» Money management firm T. Rowe Price is sometimes overshadowed by its more famous Baltimore neighbor, Legg Mason. But last year T. Rowe stole the spotlight. New **CEO JAMES KENNEDY** takes control as assets under management reach a record \$335 billion, up 24% from the end of 2005. That growth helped the company post a 23% gain in net income. The gain didn't come courtesy of star fund managers but from building on consistently good performance across a wide array of mutual funds. At the end of 2006, 80% of the firm's funds surpass the average performance of their fund peers over the past 7 years, and at least 70 have been doing so since 1996. T. Rowe's Capital Appreciation Fund is the only domestic equity or balanced fund that has made money in each of the past 16 years, says fund tracker Morningstar.



Home, sweet hybrid home.

If cars are being built to be more energy-efficient, why shouldn't homes? At BASF, we've put our energies into building an affordable house in Paterson, New Jersey, to demonstrate how (and how efficient) a home can be. Our Near-Zero Energy Home utilizes BASF's high performance products in insulating foam sealants, panels and concrete forms, and is 80% more energy efficient than the average American home. What says a hybrid should only come on wheels? Learn more at www.basf.com/energy

Helping Make
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36

VALERO ENERGY

INDUSTRY
Energy

SALES
\$91.1 billion
NET INCOME
\$5.5 billion

» The largest U.S. oil refiner, with \$91 billion in revenues, this San Antonio (Tex.) company has grown mostly through acquisitions, snapping up other plants at a fraction of what they would cost to build new. A turnaround in the refining cycle has sent earnings zooming. With no new plants built in the U.S. since the late 1970s and gasoline demand climbing, Valero is sitting pretty: It earned a record \$5.5 billion last year, almost triple what it earned in 2004. In January, 2006, **CEO WILLIAM KLESSE** replaced 25-year Valero veteran William Greehey, an industry legend who spent more than \$1 billion remodeling the company's lone Corpus Christi refinery in the early 1980s when Valero was primarily a pipeline company. The big bet paid off. Expect Klesse to be somewhat more cautious. This year he's trimming capital spending slightly, to \$3.5 billion.

37

CONSTELLATION ENERGY GROUP

INDUSTRY
Utilities

SALES
\$19.3 billion
NET INCOME
\$761.8 million

» The company formerly known as Baltimore Gas & Electric has grown far beyond its Maryland roots. While **CEO MAYO SHATTUCK III** would probably hate to hear the name "Enron" associated with Constellation, the company does a lot of what the infamous energy trader once hoped to do. As Enron and others collapsed in 2001, the once-sleepy utility dove in, snapping up power plants and customer contracts. It now owns plants from New York to California, including five nuclear units. It services business and residential gas and electricity customers in competition with local utilities in 31 states and three Canadian provinces. And it explores for oil and gas through its Constellation Energy Group subsidiary. A planned \$11 billion deal for Florida utility FPL Group fell apart because of regulatory concerns last year. But as the nation's need for power grows, and building new plants remains a challenge, Shattuck hopes to boost earnings by more than 22% through 2008.

38

TJX

INDUSTRY
Apparel retail

SALES
\$17.4 billion
NET INCOME
\$776.8 million

» The ad slogan at discount retailer TJX's T.J. Maxx chain has long been "get the max for the minimum." The company, which operates more than 2,000 stores, followed its own advice last year, slashing 250 jobs at headquarters and cutting top executives' pay by 10%. It renewed its emphasis on low-priced, chic apparel by hiring more buyers on the West Coast to make its merchandise more fashion-forward. **CEO CAROL MEYROWITZ**, promoted from president in January, also expanded jewelry counters and tested designer departments. The moves paid off as annual sales rose 9% last year, and net income gained 7%. The year was not an unvarnished success, however. TJX disclosed in January that hackers had stolen millions of credit-card numbers from its PCs over the past two years. Sales are strong, but the company could be sullied by lawsuits.



MORGAN STANLEY

Investment bank Morgan Stanley is getting back its mojo. Since former president John Mack returned to take charge as CEO in June, 2005, the firm has thrived by upgrading its businesses. Its traders are taking bigger risks and putting more of the bank's own money behind trades. While brokers are focusing more on wealthy clients who want high-octane investments,

INDUSTRY
Financials

SALES
\$76.6 billion
NET INCOME
\$7.5 billion

the firm's asset management business is launching private equity funds and acquiring hedge funds or taking minority stakes in them. Meantime, Morgan Stanley is finally getting out of a business that never seemed to jibe with its white-shoe image—the Discover credit card. Bottom line: Morgan Stanley's stock has surged 43% since Mack came back.

40

PAYCHEX

INDUSTRY
Information Technology

SALES
\$1.8 billion
NET INCOME
\$505 million

» Payday can't come too soon for this Rochester (N.Y.) payroll processing company. Paychex provides payment and other human resources functions for 550,000 small and midsize businesses. It's a predictable niche that generates huge cash flow—about \$500 million in 2006. Customers are disinclined to switch payroll service providers, and Paychex' emphasis on a well-trained workforce keeps clients content. Despite incursions from large rival Automatic Data Processing, Paychex is expanding market share, aiming to increase its client base 5% each year. In 2006, **JONATHAN JUDGE** took over as chief executive for founder Tom Golisano, who remains chairman. The transition has been smooth: Last year sales increased 16% and earnings jumped 26%. Shareholders were kept happy, too, with a robust 2.1% dividend.

Mack decided to dump the Discover business

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2



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41

COVENTRY HEALTH CARE

INDUSTRY
Managed Health Care
SALES
\$7.7 billion
NET INCOME
\$560 million

» Coventry is far from the biggest managed-care company, but lately it's looking like the rosiest of the group. While others struggled to add members, **CEO DALE WOLF** saw Coventry recruit 6,000 new patients in the fourth quarter, bringing membership to 2.5 million. Even though the Medicare Part D drug program is only about a year old, Coventry's 687,000 senior patients accounted for 15% of its net profit in the final quarter of 2006. The Bethesda (Md.) insurer's revenues have grown an average 20% a year for three years, and its medical loss ratio, or fraction of premiums it had to pay back out in claims, improved across almost all product lines in 2006. And Coventry entered the lucrative field of workers' compensation by acquiring First Health Group for \$1.8 billion. In February the insurer announced it would boost that business by paying \$387.5 million to acquire Concentra's workers' compensation unit.

42

U.S. STEEL

INDUSTRY
Steel
SALES
\$15.7 billion
NET INCOME
\$1.4 billion

» U.S. Steel sure showed its doubters. The biggest integrated steelmaker headquartered in the U.S. came out of a five-year slump to post record revenues and profits in 2004 and 2005 as steel prices soared. It did so again in 2006, even as metal prices weakened, with net income leaping 50%. Moreover, the Pittsburgh company paid down almost \$600 million in debt, doubled its dividend, and contributed \$190 million to its already overfunded pension plans. U.S. Steel managed it all by curtailing domestic output to keep prices from deteriorating and by cranking up its low-cost mills in Central Europe, where demand for steel was stronger. The payback for investors: a 52% jump in its share price in 2006. **CEO JOHN SURMA** has watched the stock rise even higher since then, lifted as well by Wall Street wagering that U.S. Steel might get gobbled up by even larger foreign competitors as the global industry consolidates.



UNITED TECHNOLOGIES

43
The \$48 billion manufacturer has delivered consistently strong returns with such brands as Sikorsky helicopters, Pratt & Whitney engines, Otis elevators, and Carrier air conditioners. **CEO George David's** dual obsessions—with process improvements and employee development—certainly help. Even his succession has been methodically planned, with Louis Chenevert becoming president and heir apparent in 2006

INDUSTRY
Industrials
SALES
\$47.7 billion
NET INCOME
\$3.7 billion

after running the Pratt & Whitney unit. While challenges loom, including a recent \$295 million fine levied by the European Commission against Otis for alleged price-fixing, investors continue to love the company. Its total return over the past three years is 49.6%.

David has put a succession plan in place

44

HERSHEY

INDUSTRY
Consumer Staples
SALES
\$4.9 billion
NET INCOME
\$559.1 million

» An ambitious restructuring plan and a move into new-product lines such as premium chocolate and snacks for nutrition-conscious consumers have Hershey predicting a sweet future. **CEO RICHARD LENNY** has also bolstered sales of higher-margin single-serve snacks aimed at on-the-go consumers and is making changes in distribution by expanding the brand's presence beyond grocery stores and mass merchant chains to home-improvement and other specialty stores. Overseas, Hershey faces strong competition from Mars and Cadbury Schweppes, but a venture with Korea's Lotte Confectionery will help it make inroads in China and other Asian markets. To increase its competitiveness, Hershey over the next three years plans to cut its workforce by 10.7%, or 1,500, and shift more of its production overseas. These moves should bring savings of \$170 million to \$190 million by 2010.

45

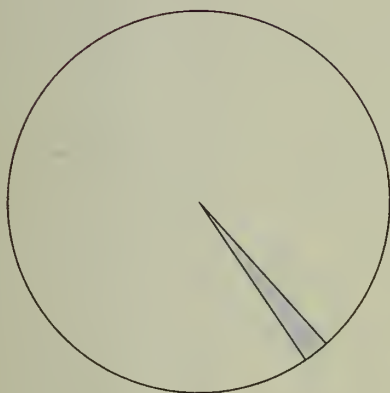
BLACK & DECKER

INDUSTRY
Consumer Discretionary
SALES
\$6.4 billion
NET INCOME
\$486.1 million

» Despite tough going amid softer housing, **CEO NOLAN ARCHIBALD** has kept Black & Decker on steady ground with a combination of market-leading innovation and cost management. Famous for killer power tools, Black & Decker had two more hits in 2006: the Auto Wrench, which adjusts with a press of a button, and a battery booster that lets users give cars a jump from the driver's seat. The company is weathering the slowdown by shifting final assembly to lower-cost regions such as Chihuahua, Mexico, and the Czech Republic. From 200 to 2006, assembly in those regions has risen to 70% of the company's total from 45%. That has produced annualized cost savings of more than \$10 million. Those savings plus a penny-pincher approach to cash management, has helped Archibald maintain record cash flow each of the last five years. The stream of money helped with the occasional acquisition, such as last year's purchase of Vector Products, maker of—you guessed it—a battery booster.



YOUR LEGACY



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46

SYNOVUS FINANCIAL

INDUSTRY
Regional Banks

SALES
\$4.1 billion

NET INCOME
\$616.9 million

» You don't have to be a behemoth based in New York or Charlotte, N.C., to generate some financial-services pizzazz. In 2006, Synovus, a banking and credit-card processing company that hails from the sleepy south Georgia town of Columbus, saw revenues jump 20.3% and net income rise 19.5%. The source of that growth: a double-digit rise in deposits and loans in its banking division, along with new payment-processing deals with issuers of credit cards. The regional bank's average return on equity wasn't shabby either, at 29.5%. **CEO RICHARD ANTHONY** has been accelerating the company's expansion into commercial and industrial lending and bolstering its retail banking portfolio. That includes an aggressive push into home-equity loans and, like its bigger banking brethren, a bid to soak up more income from ubiquitous fees.

47

LINEAR TECHNOLOGY

INDUSTRY
Information Technology

SALES
\$1.1 billion

NET INCOME
\$443.6 million

» Practically everyone making a new piece of electronic equipment has Linear Technology on speed dial. Linear builds specialized analog chips, which convert real-world signals such as power, temperature, and light into a form that digital chips can process. With such customers as makers of cars, cell phones, and huge telecom switches, Linear has been growing steadily for 25 years. And its margins, about 40%, are twice those of many rivals. That's largely because of Linear's moves to pioneer new markets when prices begin to commoditize. **CEO LOTHAR MAIER** continues to follow that blueprint. Linear is focusing on such emerging markets as power-over-Ethernet chips that would let Net-based phones get juice right through the phone cable. While the company was caught in a fourth-quarter chip slowdown and has been mentioned in the options backdating scandal, neither problem should knock steady Linear off course for long.



48

AT&T

Rapid-fire acquisitions have created the nation's largest telecom. Three deals profoundly changed the grown-up Baby Bell, formerly SBC Communications. In 2004, SBC led a deal to combine AT&T Wireless with Cingular, its joint venture with BellSouth. The following year, SBC changed its name to AT&T after acquiring that fabled telecom. And in December, CEO Ed Whitacre closed a merger with BellSouth. AT&T's assets now include the nation's largest wireless network.

Whitacre pursues mergers that promise huge synergies—\$8 billion in annual cost savings over the next three years—and aims to pump that money into innovation. The behemoth now is ramping up a \$5 billion fiber network complete with TV service.

INDUSTRY
Telecommunication Services

SALES
\$63.1 billion

NET INCOME
\$7.4 billion

Whitacre sees cost savings of \$8 billion

49

XTO ENERGY

INDUSTRY
Energy

SALES
\$4.6 billion

NET INCOME
\$1.9 billion

» XTO Energy doesn't actually find new sources of oil and gas. Instead, the Fort Worth company, under **CEO BOB SIMPSON**, has thrived by doing what it calls "wildcat exploitation." It snaps up existing wells and fields in the U.S. where production has already declined to about half the initial rate. The company figures that it can squeeze out years—or decades—worth of oil and gas at lower costs through better management and by drilling new wells in already-producing fields. The strategy has worked. Production has grown 13 years in a row. Since a 1993 IPO at a price of 13, the stock has split seven times, rising to today's 51.38. In 2006, revenues and net income jumped 30% and 61%, respectively, from 2005. There's no end in sight. XTO's proven reserves, concentrated in Texas, New Mexico, Arkansas, and nearby states, are at their highest levels ever, all ready to be tapped.

50

PNC FINANCIAL SERVICES GROUP

INDUSTRY
Financials

SALES
\$8.9 billion

NET INCOME
\$2.6 billion

» Pittsburgh's PNC Financial Services has prospered as a fast-growing regional bank, with 850 branches across seven states from New Jersey to Kentucky. **CEO JAMES ROHR** has kept adding to PNC's basic banking business, snapping up rival Mercantile Bancshares in October. But Rohr has also diversified into wealth management and fund services. As a result, while PNC's \$2.2 billion of net interest income is about where it was in 2002, before the Federal Reserve started hiking rates, income from other sources like management fees has doubled, to \$6.3 billion. Its profits also more than doubled, to \$2.6 billion. PNC ditched its stake in money manager BlackRock from 69% to 34% as part of a deal to acquire Merrill Lynch's fund business in September. That move paid off: PNC recorded a \$1.3 billion gain on the deal, and its remaining BlackRock shares doubled in the past year.

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Inside the Ranking

THE COMPANIES IN THE S&P 500, which was the starting point for our research, represent a huge universe—some 75% of the market capitalization of all U.S. stocks. We ran our proprietary data screens on these companies, then vetted the list with a board of *BusinessWeek* editors and correspondents to get the insights and commonsense judgments that purely financial measures can't provide. That process resulted in our list of 50 companies that are playing at the top of their game. For a more detailed look at the financial and management makeup of the BW 50, and to find out what companies made it through our process to the No. 51 to No. 75 spots, visit www.businessweek.com/extras.

RANK	COMPANY NAME / STOCK SYMBOL	OVERALL GRADE	PROFITABILITY * %	PROFITABILITY GRADE	SALES GROWTH RATE ** %	SALES GROWTH GRADE	STOCK MARKET VALUE *** \$ BILLIONS	12-MONTH SALES \$ BILLIONS	12-MONTH NET INCOME \$ BILLIONS	TOTAL RETURN PAST 12 MONTHS	TOTAL RETURN PAST 36 MONTHS	SECTOR
1	GOOGLE GOOG	A	32.8	A	93.3	A	136.7	10.6	3.1	23.9	NA	INFORMATION TECHNOLOGY
2	COACH COH	A	62.7	A	28.7	A	17.4	2.4	0.6	32.1	138.2	CONSUMER DISCRETIONARY
3	GILEAD SCIENCES GILD	A	40.5	A	51.8	A	33.0	3.0	-1.2	14.9	163.7	HEALTH CARE
4	NUCOR NUE	A	45.7	A	30.7	A	18.3	14.8	1.8	47.3	321.1	MATERIALS
5	QUESTAR STR	A	22.2	A	26.4	A	7.2	2.8	0.4	16.2	145.1	UTILITIES
6	SUNOCO SUN	A	36.7	A	31.4	B-	7.8	36.0	1.0	-11.8	118.7	ENERGY
7	VERIZON COMMUNICATIONS VZ	A	13.5	A	8.1	B-	108.9	88.1	5.5	20.5	15.9	TELECOMMUNICATION SERVICES
8	COLGATE-PALMOLIVE CL	A	55.0	A	7.3	B-	34.6	12.2	1.4	26.3	29.2	CONSUMER STAPLES
9	GOLDMAN SACHS GROUP GS	A	34.7	A-	43.4	A	83.3	69.4	9.5	43.9	95.7	FINANCIALS
10	PACCAR PCAR	A	34.5	A-	25.9	A	17.3	16.5	1.5	55.9	112.5	INDUSTRIALS
11	AMAZON.COM AMZN	A	31.6	A-	26.3	A	16.2	10.7	0.2	4.5	-9.0	CONSUMER DISCRETIONARY
12	COGNIZANT TECHNOLOGY SOLUTIONS CTSH	A	29.5	A-	56.4	A	12.9	1.4	0.2	56.6	281.6	INFORMATION TECHNOLOGY
13	AVON PRODUCTS AVP	A	65.1	A	8.2	B-	16.2	8.8	0.5	29.9	10.0	CONSUMER STAPLES
14	VARIAN MEDICAL SYSTEMS VAR	A	40.5	A	14.2	B	5.9	1.7	0.3	-20.6	9.7	HEALTH CARE
15	BED BATH & BEYOND BBBY	A	35.1	A-	14.1	B	11.3	6.3	0.6	10.7	-2.5	CONSUMER DISCRETIONARY
16	CB RICHARD ELLIS GROUP CBG	A	43.2	A	35.2	A	7.5	4.0	0.3	45.5	NA	FINANCIALS
17	ROBERT HALF INTERNATIONAL RHI	A	37.4	A	26.5	A	6.6	4.0	0.3	9.8	78.7	INDUSTRIALS
18	CHICAGO MERCANTILE EXCHANGE HOLDINGS CME	A	50.5	A	28.3	B+	18.8	1.1	0.4	27.3	489.3	FINANCIALS
19	ADOBE SYSTEMS ADBE	A	32.3	A-	25.0	B+	23.0	2.6	0.5	1.8	111.0	INFORMATION TECHNOLOGY
20	EOG RESOURCES EOG	A	33.3	A-	33.4	B	16.5	3.9	1.3	0.8	207.5	ENERGY

Data: Standard & Poor's Compustat

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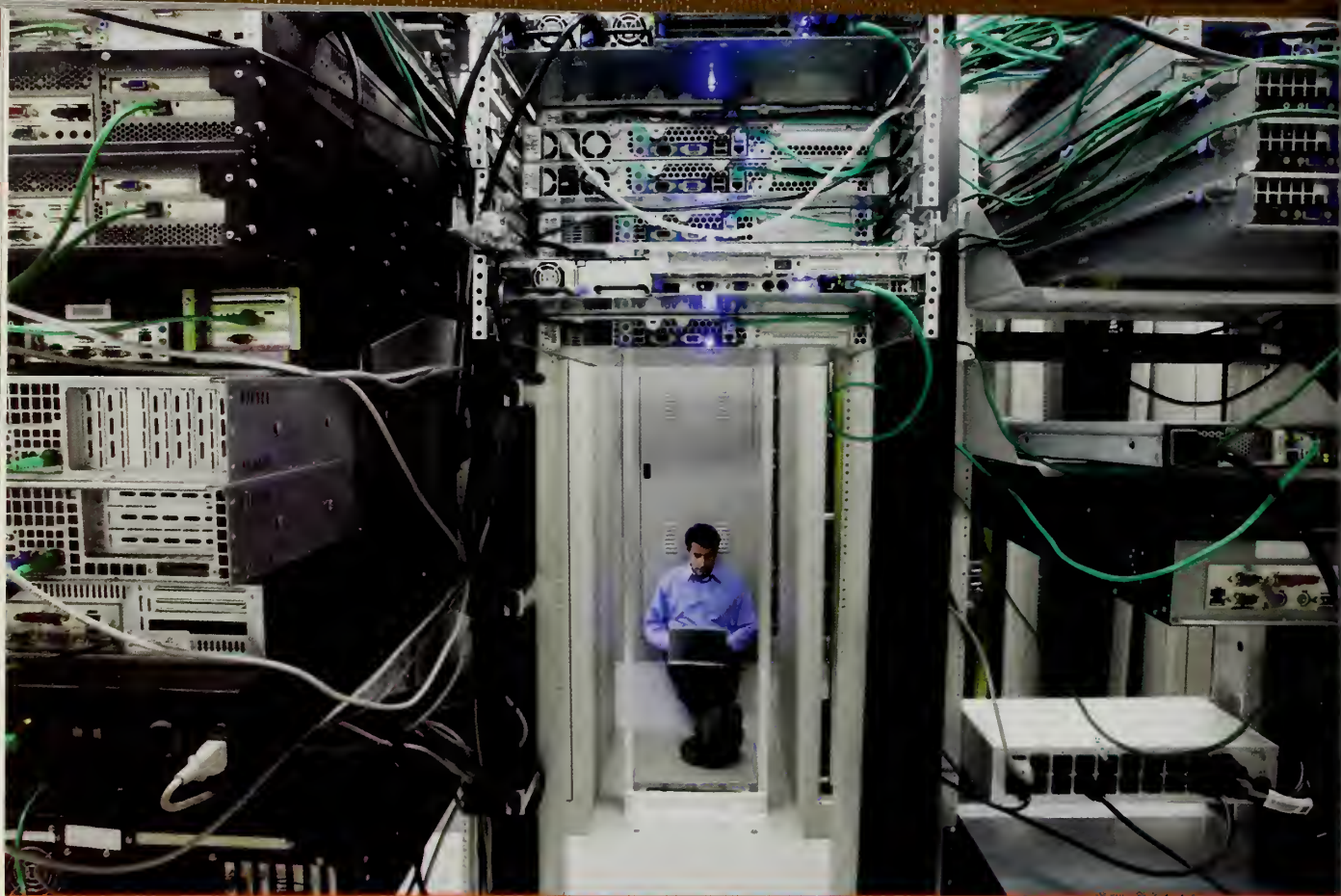
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BEST PERFORMERS

RANK	COMPANY NAME / STOCK SYMBOL	OVERALL GRADE	PROFITABILITY * %	PROFITABILITY GRADE	SALES GROWTH RATE ** %	SALES GROWTH GRADE	STOCK MARKET VALUE *** \$ BILLIONS	12-MONTH SALES \$ BILLIONS	12-MONTH NET INCOME \$ BILLIONS	TOTAL RETURN PAST 12 MONTHS	TOTAL RETURN PAST 36 MONTHS	SECTOR
21	SEMPRA ENERGY SRE	A	13.5	A-	15.0	B+	15.7	11.8	1.1	28.6	105.2	UTILITIES
22	SHERWIN-WILLIAMS SHW	A	35.3	A	13.5	B	8.9	7.8	0.6	49.6	100.7	CONSUMER DISCRETIONARY
23	LEHMAN BROTHERS HOLDINGS LEH	A	28.9	B+	40.6	A	39.1	46.7	4.0	1.2	73.0	FINANCIALS
24	ROCKWELL COLLINS COL	A	44.2	A	15.2	B	11.0	4.0	0.5	24.6	108.0	INDUSTRIALS
25	IMS HEALTH RX	A	46.3	A	12.3	B-	5.8	2.0	0.3	20.4	18.0	HEALTH CARE
26	ALLEGHENY TECHNOLOGIES ATI	A	28.3	A-	35.9	A	10.4	4.9	0.6	103.8	730.6	MATERIALS
27	ORACLE ORCL	A	38.8	A	18.7	B-	85.1	16.1	3.7	32.3	27.7	INFORMATION TECHNOLOGY
28	STARBUCKS SBUX	A	30.4	B+	23.2	A-	23.4	8.2	0.6	-14.9	65.2	CONSUMER DISCRETIONARY
29	MOODY'S MCO	A	504.2	A	18.0	B-	18.1	2.0	0.8	-2.9	96.2	FINANCIALS
30	PEPSICO PEP	A	36.4	B+	9.4	B	103.4	35.1	5.6	8.9	28.3	CONSUMER STAPLES
31	STRYKER SYK	A	31.2	A-	14.2	B	25.3	5.4	0.8	34.7	41.0	HEALTH CARE
32	BEST BUY BBY	A	31.9	A-	13.1	B	22.4	33.7	1.3	-13.1	33.8	CONSUMER DISCRETIONARY
33	UNITED PARCEL SERVICE UPS	A	30.8	A-	12.8	B-	75.1	47.5	4.2	-4.1	5.0	INDUSTRIALS
34	APPLE AAPL	A	23.9	B	47.2	A	72.8	20.7	2.4	23.5	607.4	INFORMATION TECHNOLOGY
35	T. ROWE PRICE GROUP TROW	A	36.3	A	21.7	B	12.3	1.8	0.5	22.8	84.6	FINANCIALS
36	VALERO ENERGY VLO	A	32.3	B+	35.5	B	34.7	91.1	5.5	7.6	290.6	ENERGY
37	CONSTELLATION ENERGY GROUP CEG	A	12.3	B	27.0	A	14.2	19.3	0.8	37.3	113.7	UTILITIES
38	TJX TJX	A-	47.6	A	9.1	C	12.5	17.4	0.8	13.5	20.2	CONSUMER DISCRETIONARY
39	MORGAN STANLEY MS	A-	27.0	B+	30.1	A-	78.6	76.6	7.5	27.5	32.3	FINANCIALS
40	PAYCHEX PAYX	A-	40.1	A	14.2	C+	15.5	1.8	0.5	3.4	33.4	INFORMATION TECHNOLOGY
41	COVENTRY HEALTH CARE CVH	A-	29.8	B+	20.0	B+	8.7	7.7	0.6	-8.8	87.2	HEALTH CARE
42	UNITED STATES STEEL X	A-	31.3	A	17.0	A-	10.5	15.7	1.4	64.3	147.1	MATERIALS
43	UNITED TECHNOLOGIES UTX	A-	24.2	B	15.4	B	65.4	47.7	3.7	14.1	49.6	INDUSTRIALS
44	HERSHEY HSY	A-	50.9	A-	6.1	C+	12.2	4.9	0.6	5.5	34.6	CONSUMER STAPLES
45	BLACK & DECKER BDK	A-	30.4	B+	13.7	B	5.6	6.4	0.5	0.2	70.7	CONSUMER DISCRETIONARY
46	SYNOVUS FINANCIAL SNV	A-	29.5	A-	20.3	B	10.5	4.1	0.6	17.3	40.0	FINANCIALS
47	LINEAR TECHNOLOGY LLTC	A-	27.9	B+	17.9	B-	9.9	1.1	0.4	-8.2	-13.6	INFORMATION TECHNOLOGY
48	AT&T T	A-†	10.1	C	15.0	B+	229.6	63.1	7.4	39.2	77.3	TELECOMMUNICATION SERVICES
49	XTO ENERGY XTO	A-	28.0	B	59.0	A	19.0	4.6	1.9	29.4	205.7	ENERGY
50	PNC FINANCIAL SERVICES GROUP PNC	A-	29.6	A-	15.3	B-	21.5	8.9	2.6	7.4	38.6	FINANCIALS

PROFITABILITY For nonfinancial companies, three-year average pretax operating profit before interest and special items as a percentage of average invested capital. For financial companies, pretax profits as a percentage of average shareholders' equity.

SALES GROWTH RATE Three-year average annual sales growth based on the most recently reported 36 months, calculated using the least-squares method.

*****MARKET VALUE** Share price on Feb. 28, 2007, multiplied by the latest available common shares outstanding.

TOTAL RETURN (1-YEAR) Annual dividend per share, reinvested, plus Feb. 28, 2007, share price, as a percent of Feb. 28, 2006, share price.

TOTAL RETURN (3-YEAR) Annual dividend per share, reinvested, plus Feb. 28, 2007, share price, as a percent of Feb. 27, 2004, share price.

SALES Latest available sales through the most recent 12 months. Includes all sales and other operating revenues. For financial service companies, this includes interest and noninterest income; for banks, it includes revenues for all banking operations.

PROFITS Latest available profits through the most recent 12 months. Net income from continuing operations before extraordinary items.

GRADES The overall sector letter grade reflects how the weighted average of the ranked return on capital and ranked sales growth compares with others in the same sector. For the overall grade as well as the ROE/ROI and sales growth grades, an "A" places a company in the top 7% of its sector and an "A-" in the top 14% of the sector. The actual ranking was done using the underlying numerical measures. Grades are for information only.

Note: Compustat data provided by Standard & Poor's, a unit of The McGraw-Hill Companies, from sources such as statistical services, registration statements, and company reports that S&P believes to be reliable but are not guaranteed by S&P or BusinessWeek as to correctness or completeness. This material is not an offer to buy or sell any security.

†Grade adjusted for small size of sector.

Another Inconvenient Truth

Behind the feel-good hype of carbon offsets, some of the deals don't deliver

BY BEN ELGIN

THE ORGANIZERS OF THE Academy Awards declare all their celebrity presenters to be "carbon-neutral." Vail Resorts Inc. in Colorado boasts that its chairlifts and lodges are "100% powered by wind." Seattle's municipal utility claims that its net contribution to global warming is zero.

A growing number of organizations, corporations, cities, and individuals are seeking to protect the climate—or at least claim bragging rights for protecting the climate. Rather than take the arduous step of significantly cutting their own emissions of carbon dioxide, many in the ranks of the environmentally concerned are paying to have someone else curtail air pollution or develop "renewable" energy sources. Carbon offsets, as the most common variety of these deals is known, have become one of the most widely promoted products marketed to checkbook environmentalists.

Done carefully, offsets can have a positive effect and raise ecological awareness. But a close look at several transactions—including those involving the Oscar presenters, Vail Resorts, and the Seattle power company—reveals that some deals amount to little more than feel-good hype. When traced to their source, these dubious offsets often encourage climate protection that would have happened regardless of the buying and selling of paper certificates. One danger of largely symbolic deals is that they may divert attention and resources from more expensive and effective measures.

The market for carbon offsets in the

U.S. could be as high as \$100 million, according to researchers' best guesses. That's up from next to nothing just a couple of years ago. One reason for this growth is that the U.S. remains one of the few industrialized countries that hasn't ratified the Kyoto Protocol, a global agreement setting emission limits by nation. In the absence of a mandatory national cap, some Americans have begun taking action on their own, but without widely recognized standards as to what constitutes a valid offset. As long as there are willing buyers and sellers, almost anything goes. "Right now it's a no-man's land out there," says Jennifer Martin of the nonprofit Center for Resource Solutions in San Francisco.

Hollywood celebrated environmental activism at this year's Academy Awards, and not just by giving an Oscar to the Al Gore documentary *An Inconvenient Truth*. The Academy of Motion Picture Arts & Sciences promoted the show itself having "gone green," by means of a variety of initiatives. One element: Each performer and presenter received a glass statue representing the elimination of the amount of greenhouse gas associated with a celebrity lifestyle over the course of a year. The offsets were issued by TerraPass Inc., a two-year-old for-profit company in San Francisco that identifies climate-protection efforts and, for a fee, gives its customers the opportunity to buy a piece of the environmental action. Each Oscar favor represented 100,000 pounds of emission reductions drawn from TerraPass' portfolio of offset projects.

One of the largest in its portfolio is a sprawling garbage dump outside of

**GREEN
BiZ**



PHOTO ILLUSTRATION BY SEAN MCCABE; AL GORE PHOTO BY PAUL BUCK/EPA/CORBIS; SEATTLE SKYLINE PHOTO BY GETTY IMAGES; WIND ENERGY PHOTO BY JOE SOHM/VISIONSOFAMERICA/GETTY IMAGES; WASTE MANAGEMENT'S LANDFILL PHOTO BY STEFAN HESTER



GREEN OSCAR Gore and *Truth* director Davis Guggenheim were center stage at the Academy Awards as the show promoted carbon offsets

Springdale, Ark., from which TerraPass has purchased thousands of tons of gas reductions. The vast sloping mound of the Tontitown landfill rises near stands of bare-limbed hickory and oak trees, with the blue Ozark foothills in the background. The decomposing trash generates methane, a gas 23 times as potent as carbon dioxide in trapping heat in the earth's atmosphere, melting glaciers and raising ocean levels. Waste Management Inc., the huge garbage processor that operates the facility, tends nearly 90 wells dotting the trash mountain, each giving off a barely audible hiss as it sucks methane from the depths of the landfill and delivers the gas to a single towering flare. Once torched, the gas is released into the atmosphere as less-damaging CO₂. But company officials and Arkansas environmental regulators say Waste Management began to burn methane, and continues to do so, for reasons having nothing to do with TerraPass' offsets.

'ICING ON THE CAKE'

CONCERNED THAT METHANE might be contaminating groundwater beneath the landfill, Waste Management first floated the idea for a gas-collection system in early 1999. Arkansas regulators urged the company to pursue this remedy. In 2001 the state increased its pressure by imposing a requirement for "corrective action" at the Tontitown facility. Waste Management promised to make the methane flare operational by late 2001. After probes subsequently detected methane levels exceeding allowable levels, Dennis John Burks, then chief of the Solid Waste Management Div. of the Arkansas Environmental Quality Dept., wrote to Waste Management on June 27, 2001, saying that the state "strongly



"We wanted offsets quickly, not offsets coming 10 or 20 years in the future."

*—Corinne Grande,
strategic adviser,
Seattle City Light*

urges WM to bring the newly installed Tontitown Landfill gas extraction system online as soon as possible."

Asked about Waste Management's response, Gerald Delavan, a supervisor at the Arkansas environmental agency, says: "It started out as a voluntary effort" by the company. "But it ended up being guided by 'corrective action,'" imposed by the state. Wes Muir, a Waste Management spokesman, says: "We felt a gas collection system was the most effective way to deal with this.... It was a voluntary process."

Regardless of who deserves credit for taking the initiative, one thing is clear: The methane system was launched long before any promise of carbon-offset sales. In other words, it appears that the main effects of the TerraPass offsets in

this instance are to salve guilty celebrity consciences and provide Waste Management, a \$13 billion company based in Houston, with some extra revenue.

All six other project developers selling offsets to TerraPass that *BusinessWeek* was able to contact said they were pleased with the extra cash. But five of the six said the offsets hadn't played a significant role in their decision to cut emissions. "It's just icing on the cake," says Barry Edwards, director of utilities and engineering at Catawba County, N.C., which installed a system in 1998 to turn landfill gas into electricity to power 944 homes. "We would have done this project anyway."

A big player in the growing industry of brokers and retailers marketing offsets, TerraPass was the brainchild of Karl

setting more than 117,000 tons of greenhouse gases. Ford Motor Co. and the travel Web site Expedia.com collaborated with the offset-retailer to offer customers the option of neutralizing travel-related emissions for an added cost.

TRICKLE DOWN

ARNOLD CONCEDES that TerraPass hadn't known until approached by *BusinessWeek* that concerns about groundwater contamination had led to the Tontitown methane project. TerraPass, he says, will now rethink how it evaluates such landfill gas-reduction efforts. But Arnold stands behind the legitimacy of offsets related to the Tontitown dump. He emphasizes that Waste Management acted voluntarily, and he praises an \$800,000 upgrade to the methane system last year: "That's behavior consistent with somebody trying to enhance methane capture." He also warns against getting too bogged down in the intricacies of how particular offset projects were conceived. "Let's get the market working well," he says. "That will do a lot of greater good."

As the offset market now works, intermediaries typically pocket a big portion of the money coming in. Consider two projects in the TerraPass portfolio that are run by dairy farmers in Princeton, Minn., and Lynden, Wash. Several years ago, the farmers had install

How Carbon Offsets Work

Performers and presenters at the 2007 Academy Awards each received a certificate representing elimination of a year's worth of greenhouse gas emissions:

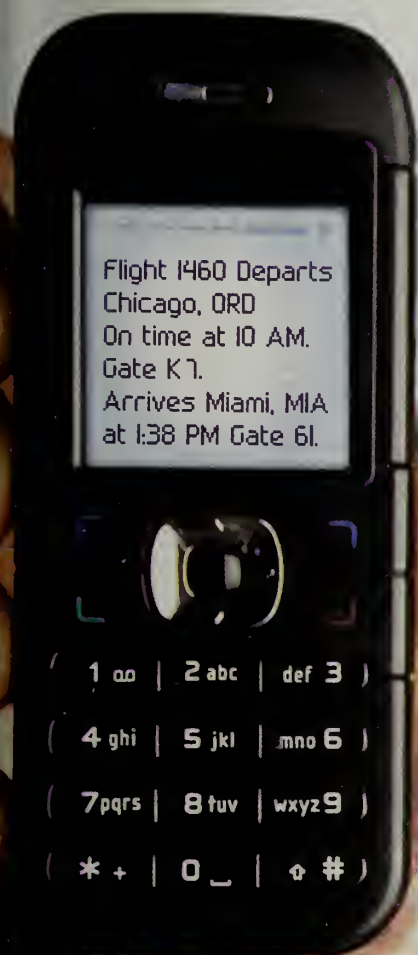
1 THE OSCARS
organizers paid TerraPass, a carbon offset service, to identify projects that reduce carbon dioxide

2 A FOR-PROFIT COMPANY,
TerraPass took a share of the money and passed along the rest to landfills and other projects that reduce greenhouse gases

3 PERFORMERS AND PRESENTERS
at the awards show went home having been declared "carbon-neutral" for a year



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expensive equipment that uses methane from cow manure to generate electricity. In theory, the promise of offset income encourages farmers to invest in such equipment. TerraPass typically sells offsets for about \$9 per ton of carbon dioxide, or the corresponding amount of methane. The company takes a cut of that \$9, but won't say what the percentage is. A broker that introduced TerraPass to the dairy farmers also took a cut. In the end, the farmers say they each received less than \$2 a ton out of the original \$9. Darryl Vander Haak, the farmer in Washington, says he's happy with the \$16,000 he earned last year from offset sales. But offsets didn't factor into his decision to start the methane venture, he adds.

TerraPass' Arnold nevertheless maintains that "the [offset] prices out in the market now are changing behavior." The fees intermediaries collect cover costs such as auditing projects and marketing to buyers. "It's much like Starbucks," Arnold says.

"What do you think Starbucks pays for a pound of coffee, and how does that translate into a \$3.50 latte?"

Seattle, the home of Starbucks, made an astounding announcement in 2005: Its municipal utility, Seattle City Light, had eliminated its contribution to global warming. The power company still annually spewed some 200,000 tons of greenhouse gases. But Seattle said it had negated every last ton by paying other organizations around the country to curtail their emissions. "We can power our city without toasting our planet," Seattle Mayor Greg Nickels declared.

But as in the case of the Oscar presenters, the bulk of the pollution reductions for which Seattle paid would have happened regardless



Middlemen pocket a big chunk of the money generated by offsets

of its offset deal. The city's experience illustrates the difference between more expensive methods of cutting greenhouse gases close to home, vs. more far-flung deals with third parties.

In 2000 the Seattle City Council imposed the long-term goal of Seattle City Light becoming carbon-neutral. At first the utility pursued local projects, such as one in 2003 with Seattle's municipal trucking department. The strategy was to convert 900 diesel vehicles to a more climate-friendly blend of fuel containing 20% biodiesel. The blend was expected to cost an additional 25¢ a gallon, so Seattle City Light agreed to chip in half of the difference. In exchange, the utility has taken credit for the relatively modest 700 to 1,400 tons of annual green-

MARKET FORCE
TerraPass' Arnold claims offsets are helping change companies' behavior

house-gas reduction to cleaner fuel allowed. This arrangement, which improved air quality in Seattle, wouldn't have occurred without the financial incentive provided by Seattle City Light.

"Our approach initially was very strict," says Corinne Grande, a strategic adviser to the utility. "The project would not happen if the check came in the mail from us." But Seattle sought to offset hundreds of thousands of tons of gas a year. "I wanted offsets quickly, not offsets coming 10 to 20 years in the future," Grande says.

City officials cull dozens of offers from various middlemen. Several factors drew attention to a DuPont project reducing emissions at its Louisville (Ky.) plant that manufactures the refrigerant Freon, Grande calls. DuPont enjoyed a strong reputation for reducing greenhouse gas

emissions, and the Louisville plant provided the chance to buy in bulk. Seattle City Light purchased its largest block of offsets in 2005 from DuPont, for nearly \$600,000. The 300,000 tons of CO₂ reductions were enough for Seattle to claim "net zero" emissions for its utility, with plenty left over for 2006. The price, at only \$1.50 per ton, was tiny compared with that of the biodiesel venture, which ran as high as \$220.

NO DETAILS

DUPONT DESERVED to be rewarded for its climate efforts, says Grande, the adviser to Seattle City Light. The chemical company "took a chance on doing more than they needed to do," she adds. "We like to encourage the continued destruction of greenhouse gases."

But Seattle's offset purchase did prompt the cleanup of the once-dirty Louisville plant. DuPont had begun



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Director, Global Supply Chain Marketing
BAX Global

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Vice President, Global Sales
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searching improvements all the way back in 1995 and installed a more environmentally friendly system in 2000, five years before Seattle began paying DuPont. "We would have continued with these emissions reductions anyway," says Stephanie Jacobson, a DuPont spokeswoman.

In a legal twist, Washington's state Supreme Court ruled earlier this year that the Seattle utility lacks authority to use ratepayer money to fight global warming. The state legislature could counteract that decision, but meanwhile the future of Seattle's offset program is uncertain.

The growing green marketplace of-

ness." He adds that even if his business obtains its power from a standard utility, which in the Rocky Mountain means relying mostly on coal, "we're helping to push forward development of new wind projects."

Which new wind projects? Katz says he relies on a broker to select appropriate recipients. His broker, Renewable Choice Energy of Boulder, Colo., declines to identify any of the investments it makes on behalf of Vail Resorts or its scores of other clients. Neither party will disclose the price of the RECs. What Renewable Choice will say is that the RECs it buys and sells are confirmed by the Center for Resource Solutions, the San Francisco nonprofit, as representing power not counting toward any government mandate and coming from projects built since 1997. RECs related to more recent built projects are thought more likely to spark development of new projects.

Still, this kind of skepticism provokes skepticism. "If neither a seller of RECs nor a buyer will provide details of how, exactly, their transaction is reducing carbon emissions, I would suspect it's vaporware," says Randy Udall, director of the Community Office for Resource

Efficiency, an Aspen (Colo.) nonprofit that promotes renewable energy.

Some developers go further, scoffing at the basic economics of RECs, many of which sell for \$1 to \$3 per megawatt hour—a small fraction of what wind projects can attract in federal tax incentives. Voluntary REC purchases "are pure corporate marketing and image management" for buyers, says Michael O'Sullivan, senior vice-president for development at Juno Beach (Fla.)-based FPL Energy, the nation's largest developer of wind power. "The economics of our wind investments have to work without the green credits."

More broadly, the proliferation of suspect RECs and offsets may persuade consumers and businesses that preventing climate change comes cheap, says Anja S. Kollmuss, outreach coordinator of the Tufts Climate Initiative, an advocacy group affiliated with Tufts University. "We cannot solve the climate crisis by buying offsets and claiming to be climate-neutral," she adds. "Nature does not fall for accounting schemes." ■

Where Offsets Come From

Carbon offsets represent reductions of greenhouse gases in several settings

LANDFILLS burn off methane generated by decomposing trash (right)

WIND VENTURES produce clean electricity that replaces power from fossil fuels

DAIRY FARMS convert methane from cow manure into electricity

FOREST PROJECTS plant trees that soak up carbon dioxide



fers an alternative to carbon offsets known as renewable energy certificates, or RECs. When RECs work properly, producers of wind-generated power and other "renewable" energy sell the certificates as a way of promoting the creation of additional renewable energy sources.

One RECs buyer is Vail Resorts, which runs ski and vacation destinations in the West. Vail Resorts declares in marketing material that it is now "100% powered by wind." But this claim isn't literally correct. Vail Resorts contemplated building expensive mountaintop wind turbines to power its ski lifts and other operations. But instead it decided last year to enter a multiyear agreement to buy, for a fraction of the cost, RECs representing 152,000 megawatt hours of wind-generated electricity each year, equivalent to its annual use. "We're in the travel business," says Rob Katz, chief executive of Vail Resorts. "We're not in the electricity-generation busi-

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'A McKinsey Of Pop Culture'?

Steve Stoute is making hot sellers out of cold brands by turning execs on to "the tanning of America"

BY TOM LOWRY

SEVERAL MONTHS INTO his new job as vice-president of U.S. marketing and advertising for General Motors, Mike Jackson came to the conclusion that the automaker was just not cool enough. Young, urban trendsetters on the East and West Coasts were not paying attention to GM's cars. The message being sent to consumers, Jackson says, was all wrong. "We worried far too much about the sheet metal, color, etc.," he explains. "What we really needed to worry about was connecting emotionally with our consumers." So Jackson picked up the phone last spring and called Steve Stoute.

More executives overseeing brands that have gone stale are turning to the 36-year-old consultant and former music executive for help. Stoute's agency, Translation Consultation & Brand Imaging, offers to imbue brands with a combination of hip-hop ethos and practicality to help reposition products, from Chevy Impalas to Crest Whitestrips to Reese's peanut butter cups. The end result is for brands to resonate with a younger, more trendy audience. Other successful entrepreneurs have emerged from the hip-hop scene, such as Russell Simmons and Sean "P. Diddy" Combs, to help put urban fashion and lifestyle into the mainstream. But Stoute is more closely aligned with a new guard of innovation consultants providing strategies that go beyond tricked-out sneakers and jeans. His message: Companies have not embraced the changes in the culture to be able to talk to a new generation of consumers. "So many

executives," says Stoute, "are lost in the confines of their own building." Besides GM, Stoute has successfully taken his mantra to clients that include McDonald's, Procter & Gamble, Hershey, Microsoft, and Estée Lauder.

Now Stoute seems to be gaining respect on Madison Avenue. Interpublic Group of Companies Inc., the \$6.2 billion-a-year global advertising conglomerate, is in talks with Stoute to buy a majority stake in Translation, say sources close to those talks. If the deal is closed, IPG would get schooled on Stoute's approach to brands and access to celebrities, while Translation would gain entrée to IPG's large client base and deeper pockets.

As an African American with strong relationships to hip-hop artists (music icon Jay-Z is a good friend and business partner), Stoute knows how easy it is to pigeonhole Translation as a black ad agency. He immodestly characterizes his firm as "a McKinsey of pop culture." By that he means that Translation is called upon by companies facing strategic challenges. "These are companies who know they have to take advantage

INNOVATION CASE STUDY

of global trends, but at the same time are afraid of jeopardizing core businesses," says Stoute. "We show them how to walk that thin line. It often comes down to showing them the language and ton-

ality needed to reach consumers."

But Stoute also says he's helping executives understand a phenomenon that he refers to as the "tanning of America." It's a generation of black, Latino, and white consumers who have the same "mental complexion," he says, based on "shared experiences and values." Rap and hip-hop, starting in the late 1980s when white suburban kids began snapping up music by mostly inner-city artists, provided the first glimpse into the shift. "Rap was a litmus test for whether the culture was headed," he says.

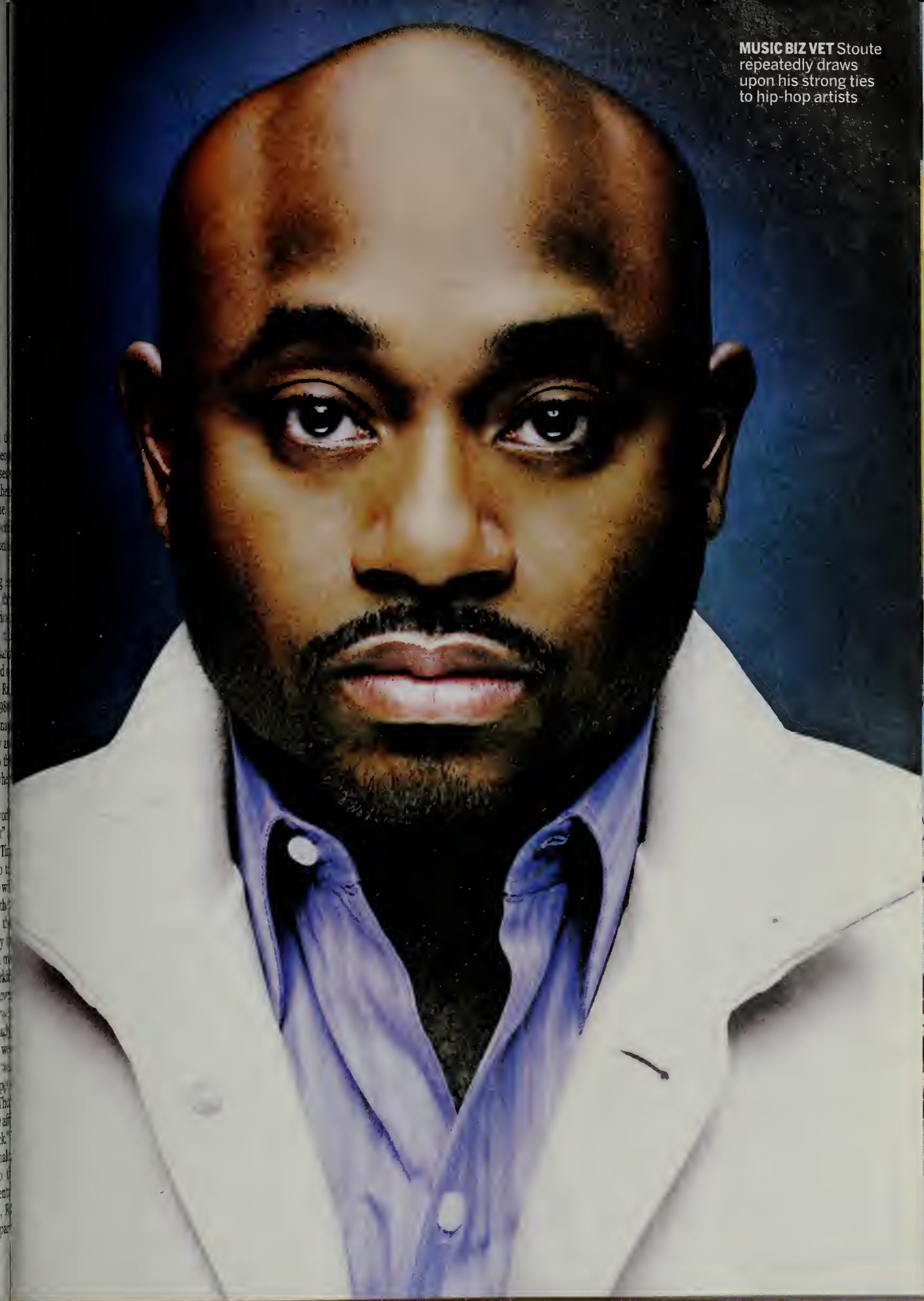
To connect McDonald's to this world, Stoute helped create its "I'm lovin' it" campaign featuring pop star Justin Timberlake. That was relatively easy. To convince executives, it was all about coming up with a new ad. Stoute has encouraged them to go much further and told them that could be blowing a big opportunity by reaching young adults. They have a million-plus young people working for them who come to the job every day ashamed of what they wear. "The uniforms are ugly," says Stoute. "If the workers were actually proud of what they were wearing, it could be a huge opportunity to promote the brand. The kids wouldn't want to change at work and stuff it in a backpack."

Stoute suggested McDonald hire top designers to redo uniforms under urban-centric brands such as Sean John, Icewear, FUBU, American Apparel,

“So many executives are lost in the confines of their own building.”

—Stoute's message: Companies have not embraced the changes in the culture to be able to talk to a new generation of consumers

MUSIC BIZ VET Stoute repeatedly draws upon his strong ties to hip-hop artists



and Tommy Hilfiger. The chain is considering the move. "We know the cutting edge comes from the African American and Hispanic communities," says Bill Lamar, McDonald's senior vice-president of marketing, "but then crosses all people."

Stoute knows those communities well. Raised in Queens, N.Y., he was barely out of his teens when he became a road manager for rap act Kid 'n Play. He would go on to become a manager for rapper Nas and a young female hip-hop soul singer named Mary J. Blige, now one of the music industry's biggest successes, who won three Grammy Awards this year. From there, Stoute was recruited by Sony Music and later Interscope Records of the Universal Music Group. But he was becoming fascinated with the broader playing field of brands. He left music to join veteran ad man Peter Arnell as a

rose quickly," says Fireman. "But he made a very strong case for why we needed to be more cosmopolitan." The breakthrough for Stoute was convincing Reebok's executives that you couldn't position the sneakers on performance capabilities. "Nike had that locked up," says Stoute. "Instead, they needed to align the brand to the sound and rhythm of sports, with fashion."

'RETAIL THEATER'

FOLLOWING THE SALE of the Arnell Group to ad giant Omnicom, Stoute in 2004 launched Translation with a 10% investment from his old employer, Interscope Records. Now housed in the penthouse of a 12-story Midtown Manhattan building, Translation employs nearly 50

INNOVATION CASE STUDY

major record labels including Motown and Virgin. Stoute's other deputy is Vice-President for Strategy John McBride, an industrial designer by training who last worked as a research scientist and project director in Eastman Kodak's innovation hub.

Once a client hires them, Stoute, Wright, and McBride often brainstorm ideas early on with sketches, music, a video clips. When Hewlett-Packard (HP) came calling three years ago, the challenge was to create HP brand awareness in the home entertainment area. Compared with slick products from Apple and Sony, says McBride, HP wasn't regarded as a real player, making it hard for a PC maker to claim "we're cool, too." Translation started by signing Gwen Stefani to sing her hit *Hollaback Girl* to help promote digital cameras. More recently, during HP's "The Computer Is Personal Again" campaign, Stoute once again called on Jay-Z, who helped launch ads in which the rapper is heard but his face is never seen. That helped give HP a celebrity appeal, says McBride.

Still, not all of Stoute's ideas fly. Some companies view them as just too far off. When he tried to help Coors overhaul its brand, he suggested less emphasis on the brand's "rugged" image and more on its brewing processes and a more effort to create a new high-end aura. Says Stoute, "We were attempting to make Coors an arbiter in the renaissance of sophisticated beer drinking." The pitch made

But Stoute's most important test will be changing perceptions about GM. Translation's assignment is to help the carmaker increase awareness for its models among a growing

and influential buyer group, 25 to 34-year-olds who live in cluster metro areas on the coasts and along the perimeter of the southern U.S. The task is to get them to think about GM the way they were already thinking about Toyota and other Japanese models. The mandate, says Stoute, is "to think of ways to spark contagious consumer behavior."

So far, Translation has helped GM redeploy Tiger Woods from the Buick brand to what Stoute believes is a more convincing role, as a spokesman for all

BIOBOX STEVE STOUTE



TITLE: Chairman, chief creative officer, Translation Consultation & Brand Imaging.

BORN: June 26, 1970, New York.

EDUCATION: Attended five colleges in two years, including Queens College. No degree.

FAMILY: Single; two-year-old daughter. Parents are originally from Trinidad and Tobago. Mother is a retired nurse, father a retired marine engineer.

OTHER BUSINESSES: Majority owner of Carol's Daughter, a beauty and skin-care company; owns Zino Platinum, a cigar line in partnership with Davidoff. Developing a line of sake.

PASSIONS: Video games, especially *John Madden Football*. Collects old video game consoles and vintage cell phones.

IF HE WASN'T DOING WHAT HE'S DOING: "I would love to have the best five-star travel agency in the world. I'm a big fan of the service business. Great customer service will keep you in business until you decide to stop caring about the customer."

NUMBER OF SUITS HE OWNS:

40. Armani is his favorite designer. Also likes Ralph Lauren's Purple Label.

CAR: "I move around in a Cadillac Escalade."

FAVORITE MUSIC: Loves '80s R&B and late-'80s hip-hop.

MENTOR: Jimmy Iovine, chairman of Interscope Geffen A&M Records, for whom Stoute once worked.

BEST ADVICE: "Stop playing for the wrong audience."

A BRAND HE WOULD LIKE TO MAKE OVER: The Internal Revenue Service. "The IRS should no longer hide behind the stick and allow fear to dominate its image. There is an opportunity to illustrate to Americans that the IRS is of value to them in ways both societal and personal."

partner in his business, the Arnell Group. At Arnell in 2003, Stoute worked with Reebok, at the time a stagnant brand that needed to revamp its image. He brokered Reebok's ad campaign with Jay-Z, whose S. Carter Collection by Rbk (Jay-Z's real name is Shawn Carter) made Reebok a big hit on city streets. "Steve was very good at getting our whole organization to buy in on this new direction," says former Reebok CEO Paul Fireman, who worked closely with Stoute to revive the brand. There was resistance from the organization. "Sometimes the fear factor

people. Stoute has his own method for keeping in touch with contemporary culture. He frequently invites his cohorts to join him for what he calls "retail theater." He loves going to department stores and malls to watch people. "I like to see how they touch fabric, or view a display," he says. "Or listen to what they say to their husbands. For me, it is more fun than going to the movies."

Stoute works most closely with two top deputies. Charles Wright, Translation's chief strategy officer, spent seven years in marketing and product management at

> > >



V



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Apple's genius device offers important lessons. What the iPod really represents is simplicity and functional minimalism. Take a cue: Communicate your brand with as few words as possible.

Be Truthful

That means being authentic. It's not enough to be up-front about product claims. If you want to thrive in pop culture, you have to watch more TV, listen to more music, and spend less time on the golf course.

Listen to Your Colleagues

Your workforce is also your consumer. If they don't believe in your brand, then you face an uphill battle getting consumers to believe. They know if your product is good, if the creative is good, and if they are moved. Is it good? Prove it to them first.

Take Your Teenager Shopping

No one knows the future, but teens are more perceptive than most. If you spend time observing them, you'll understand your brand's strengths and weaknesses. Remember, your kid can help.

the spread of catered food w-surfing star Laird Hamilton and model and actress Carr Electra. GM's marketing ch Jackson gushed that the glorious scene had just the kind of glitzy excitement he had hoped would envelop GM when hired Stoute.

FEELING CHEVY

SINCE THAT BIG NIGHT, Stoute has focused most intently on the stodgy Chevrolet brand. The challenge was to make Chevys more appealing to the young with "a metro mindset, that 20-year-old independent-thinking person," says Ed Peper, general manager of Chevrolet. "One of the first things Steve asked me was: 'Do you know that there have been 700 songs written about Chevy? Why aren't you leveraging that?'" It became abundantly clear to Peper that

GM. "Tiger and GM share similar values of integrity and, most importantly, diversity," he says. Stoute also connected GM with Jay-Z on Jay-Z Blue, a branded, lavender-tinted, electric blue that will be available on the GMC Yukon. Translation is also creating a campaign for the reissue of the Camaro, the iconic 1970s muscle car. Stoute is talking with the advertising agencies responsible for all GM models about marketing alternatives, such as social media, that go beyond traditional TV and print outlets.

It's still too early to tell if GM is reaching new consumers. Unsurprisingly, Stoute believes the results so far are positive. Look no further, he says, than

the January debut of Jay-Z Blue. From Detroit to Beijing, the news was featured on the front pages of 26 national and international Sunday papers.

On the night of the premiere of Jay-Z Blue, Stoute was in Detroit backstage in a green room. He had flown in from New York with Jay-Z to introduce the color and help kick off a GM-sponsored fashion show of cars and celebrities, the first of its kind for the automaker. As Stoute sipped a Budweiser in a large, heated tent erected for the event not far from GM's headquarters, he mingled with supermodel Petra Nemcova, actor Christian Slater, and Oscar winner Jennifer Hudson. Not far from

Chevy hadn't done enough to make its brand with music. So Stoute suggested bringing in Grammy-winning hip-hopper T.I. to help sell the Impala. An ad campaign featuring T.I.'s song *Top Back* first aired on MTV and Black Entertainment Television in early February. Chevy, in turn, sponsored T.I.'s latest music video. T.I. appears in another spot that GM is calling "Ai We Got Love," which launched during the Super Bowl. The spot also features Mary J. Blige, Dale Earnhardt Jr., and a group of regular folks fawning over their cars. "It's damn near an emotion driving a Chevy," says Stoute. "I want people to feel that." ■

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Little Dogies, Big Controversy

Beef from Scott Simplot's cloned cattle could soon be on the menu if the FDA says O.K.

BY PALLAVI GOGOI

IT'S A COLD FEBRUARY MORNING, and a thin layer of snow covers the ground at the Simplot ranch in Grand View, Idaho, about an hour south of Boise. Scott R. Simplot drives out to one of his nearby fields to see the cows giving birth. In the windswept plain, the tall, wiry 90-year-old asks a ranch hand how the new calves are doing. He smiles when he hears that the first 26 calves weigh in at about average for the breed, 78 pounds each. But these are no ordinary calves—they are the offspring of clones. "Great news," says Simplot.

This is the beginning of a grand experiment at J.R. Simplot Co., one of the largest privately owned companies in

the U.S. Founded by Scott's father in 1923, it produces food, fertilizer, and livestock and is one of the first large beef-producing companies anywhere to clone cattle and breed them on a commercial scale. Neither clones nor their nonclone offspring are in the food-distribution system now. But if the Food & Drug Administration gives its approval, as expected, Simplot plans to bring beef from the offspring to market by next year. No other company has been nearly as aggressive in this controversial arena. "Simplot is a pioneer in many senses," says Michael MacNeil, a research geneticist at the Agriculture Dept.'s research service in Miles City, Mont.

The cloning effort is spearheaded by Scott, the youngest son of John Richard

Simplot, now 98, one of America's legendary entrepreneurs. J.R. was an eighth-grade dropout who left home in the early 1920s at the age of 14 to set up his own pig farm—the first step to becoming a billionaire potato baron. Scott's personality is in striking contrast to that of his hard-driving dad. Unassuming, with a thoughtful, almost professorial air, he holds an MBA from the University of Pennsylvania's Wharton School. Scott chafed under his father's strict hand and ran away repeatedly in his youth, but he clearly inherited some of his father's drive. "I guess we do share the same DNA," concedes Scott, who is now chairman of J.R. Simplot.

PROUD PAPA

Simplot's ranch has cloned 22 head of cattle over four years

WAVES OF PROTEST

BECAUSE HE HAS invested energy and money in cloning, Scott is in the crosshairs of a national debate. Ever since Dolly the sheep was cloned in 1997, people have debated the promise and pitfalls of trying to create genetic copies of animals. The controversy was reignited last December when the FDA issued a preliminary report concluding that meat and milk from clones are safe for consumption, opening the door for commercial sales. The FDA has asked for public comment on the issue through Apr. 2, but it appears likely the agency will give

final approval by the end of this year.

That prospect has set off waves of complaints. In February about 100 protesters marched outside the U.S. Capitol, some dressed in cow costumes and chanting "Cloney Baloney." Their main demand is that meat and milk from clones be labeled as such. "Consumers have a right to know what's in their food," says Jerry Greenfield, co-founder of Ben & Jerry's Homemade ice cream, who was at the protest. The Consumer Federation of America and the National Farmers Union also joined the outcry. Supermarket chains such as Whole Foods Market and Wild Oats Markets say they won't carry meat or milk from clones, and milk processors Dean Foods and Organic Valley Family of Farms insist they won't use cloning in their production, either.

This mystifies Scott Simplot. Cloning, he says, is just another kind of technological advance, like fertilizer, that we should be using to full advantage. He also objects to the idea of labeling food products from clones since that will kill the business before it starts. "The people who are having a fit over this are using technology every day in their lives," he says.

FRIES AND CHIPS

TECHNOLOGY IS practically a religion to the Simplots. In 1941, J.R. bought a dehydrating machine, leading to his first big sale to the U.S. military: millions of pounds of dehydrated potatoes and onions during World War II. In 1953 he developed the frozen French fry and became the largest supplier of fries to McDonald's Corp. Scott is following the same path as his father. Starting in 1980 he persuaded J.R. to put \$18 million into semiconductor maker Micron Technology. The value of that stake soared to more than \$1 billion. Excitement over cloning today reminds him of the early days of computer chips. "There was a feeling that great things were going to happen," he says.

On this chilly morning, Scott steers his white Jeep Cherokee south out of the ranch to show off the high-desert landscape where his cattle graze year-round. Vegetation is sparse, and steam rises from the ground in spots, signs of hot springs nearby. The Simplot family is one of the largest private landowners

BIO BOX SCOTT SIMPLOT

BORN Oct. 11, 1946, Boise, Idaho.

LINEAGE Youngest son of Idaho potato baron J.R. Simplot, a self-made billionaire. J.R.'s "do it because I told you to" style caused Scott's two older brothers to rebel and reject their father's business.

CHILDHOOD When he was 12 and 13, Scott spent summers herding cattle on the open plains with company cowboys. The next year he worked on the family ranch, filling cattle and horse troughs with water and feed, baling hay, and building fences. In high school he ran away from home repeatedly, once driving all the way to California.

EDUCATION BS, University of Idaho; MBA, Wharton School.

FAMILY: Lives with his second wife, Maggie; two daughters from his first marriage; and two granddaughters.

INTERESTS Meteor craters, especially a giant one near Beaverhead, Idaho, that measures about 90 miles in diameter.

ZEAL Believes technology makes great things happen. Besides cloning, he's using genetics to create potatoes that

yield healthier French fries and is backing a Taiwan company that sells energy-saving lightbulbs in China.

J.R. AND SCOTT CIRCA 1964



in the country, with about 270,000 acres stretching from southern Idaho down to Nevada. "Our cows fend for themselves out here," he says. "They calve here and walk miles foraging for food. They have to work hard for a living."

During a drive to Bruneau Canyon, clouds swoop in, and the Jeep is quickly surrounded by lightning and thunderclaps. A hailstorm leaves the road covered in a glistening white carpet, and then the sun breaks through the clouds. At times, Simplot stops the truck to look at the brands on the snow-covered cows to see whether they belong to any of the family's 16 ranches. He tells the story of a cow named Bruneau that stayed healthy for 17 years, unusually long for a ranch cow, and had 13 calves, more than twice the typical number. Her ability to thrive in rough country impressed Simplot—so he cloned her. "The miracle is that nature has preselected her, and now we can reproduce her, something we couldn't have done before," he explains.

Over the past four years, Simplot's crew has cloned 22 head of cattle. They take cells from donor animals, fuse them with eggs that have been stripped of genetic

material, and place the embryos in cows. The calves are born after the usual nine months and are genetically identical to their donors.

Sounds simple enough but cloning is no trivial task, with a success rate of about 17% at best. Each clone costs about \$16,000 to produce, so cows and bulls are selected for traits that are particularly important—one is cloned because it produces double the usual 2,300 gallons of milk a year, another because of high-grade meat, with plenty of marbling within lean muscle. The clones of the animals are then bred with ordinary cattle to produce as many calves as possible. Today the ranch is expecting close to 100 offspring from two male clones bred to uncloned females.

Clearly, Simplot is taking a huge gamble. If protesters gain traction and the FDA rejects food from clones, his investment will be wiped out. Even if such products are approved, labeling of cloned meat and

milk could make them a difficult sell. Politicians are already lining up against cloning. "The American people don't want this. They find it repugnant," says Senator Barbara A. Mikulski (D-Md.) who has introduced a bill called the Cloned Food Labeling Act.

One common criticism is that the science is still new—the first cow was cloned in 1999. And animal rights advocates complain that clones can be deformed and often die at birth. In any case, polls suggest most consumers plan to steer clear of clones. The Gallup Organization reports that over 60% of Americans think it's immoral to clone animals. The Pew Initiative on Food & Biotechnology found that a similar majority say they won't buy cloned milk even if the FDA approves. But Scott stands firm in his belief that we are at the dawn of a new era with stronger animals that produce better food. "It would be a travesty for us to know as much as we do," he says, "and not be able to bring it to the table." ■

BusinessWeek .com

ONLINE: For a debate on the pros and cons of cloned foods, go to www.businessweek.com/go/07/clones.



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Parlaying Casinos Into Empires

Why Indian expansion beyond gaming is triggering a backlash on Main Street

BY CHRISTOPHER PALMERI

TWENTY-THREE BILLION dollars. That's what Indian casinos rake in each year, according to the National Indian Gaming Commission. That's more than the gambling revenues of Nevada and New Jersey combined. And it's the kind of money that buys a lot of commercial and political clout. "We're creating such opportunity," says Ray Halbritter, chief executive of the Oneida Indian Nation of New York, whose Turning Stone Resort & Casino near Syracuse generates some \$100 million in gross annual profit.

Tribes with gambling operations are expanding fast, and they're moving into an astounding variety of businesses. To name a few: banks, shopping malls, a women's basketball team, a mutual fund, and big brand-name companies like the Hard Rock International Inc. chain of cafés, hotels, and casinos.

Wall Street is all over this. The likes of Wells Fargo, CIBC World Markets, and Bank of America are all raising debt for the tribes. In February the chiefs and their financiers, lawyers, and political consultants met at the Venetian Resort Hotel Casino in Las Vegas for the semi-annual National Native American Finance Conference. There they talked shop and discussed various controversies bubbling up as the tribes move beyond gaming.

Indian commercial expansion is stirring up some ill will on Main Street. Because tribes are considered sovereign nations, they can operate businesses on their land without adhering to the same legal, tax, and regulatory rules as nontribal businesses next door. What's stirring much of the controversy is the tribes' practice of buying up land and asking the feds to put it "in trust,"

which effectively means extending tribal sovereignty over it. Not only does that take the land off local tax rolls, critics say, it gives the tribes an unfair advantage over mainstream business. In towns near reservations, there are increasing calls for Indians to operate on the same playing field as everyone else.

So far, the Indians are mostly competing with small businesses—gasoline sellers, B&Bs, convenience stores. But the Hard Rock deal reveals larger ambitions. And it may not be long before Indian sovereignty becomes a bigger issue for the restaurant, hospitality, and even manufacturing industries. Observes John W. Kindt, a professor of business administration at the University of Illinois who has testified against so-called reservation shopping before Congress: "All bets are off when businesses compete with tribes."





NATION BUILDER
Oneida CEO Ray
Halbritter at
Turning Stone

The tribes see in their newfound clout and wealth just desserts for historical wrongs. They are using their power to claim territory they believe is rightfully theirs. And they aren't shy about lobbying Washington to protect billions in federal aid and the right to operate in accordance with their own laws and regulations. Last year, according to the nonprofit Center for Responsive Politics, the tribes contributed 7.4 million to national election campaigns. The tobacco industry gave half as much. Tribal Representative Max Baucus Jr. summed up the tribal zeitgeist in New York's Times Square in December when he announced the Seminoles' Hard Rock deal: "Our ancestors sold Manhattan for trinkets," he said. "We're going to buy Manhattan back, one burger at a time."

SEMINOLE PROPERTY
The tribe has big plans for the Hard Rock brand

The Indians

have been acquiring mainstream companies for a while. But nothing on the scale of Hard Rock. The Seminole Tribe of Florida, destitute as recently as the 1980s, paid \$965 million for the company's global operations. In early March, the Seminoles raised \$1.2 billion to complete the deal and restructure existing debt. Merrill Lynch & Co. raised the money, and Piper Jaffray & Co. provided financial advice.

Over the next few years the tribe aims to open Hard Rock theme parks, casinos, and eateries from Myrtle Beach, S.C., to Macao. One possibility: expanding onto other tribes' land. "It's not only the largest deal an Indian tribe has done, it's one of the largest in the gaming industry," says Jeffrey Carey, a Merrill Lynch investment banker who worked on the deal. "It represents a change in the balance of power in Indian country."

The Hard Rock acquisition is notable

not only for its size and ambition. It's also one of the few Indian companies that will operate as a taxpaying corporation. Yes, the Seminoles' seven Florida casinos generate the tax-free money that will help pay the interest on the debt. But the tribe can't very well claim sovereignty for Hard Rock properties when they're located in places like New Orleans' French Quarter, where Indians have no historic claim.

Most tribes, though, are happy to use sovereignty to further their business ambitions. Case in point: the Chickasaw Nation of Oklahoma. Along with foreign partners, it aims to play a role in the resurrection of the MG, the iconic British sports car. The tribe has tied up with China's Nanjing Automobile Group, which owns the MG brand. Last year the Chickasaws bought 25% of a 675-acre industrial park in Ardmore, Okla.—land that was once theirs. By fall, 2008, they hope to start building the MG TF

(TOP TO BOTTOM) JASON GROW; JARED LAZARUS/MIAMI HERALD/WPN

coupé, with parts made in Nanjing and Birmingham, England.

The tribe has applied to the Bureau of Indian Affairs to put its land in trust. That way they won't have to pay property tax or inventory taxes on the parts flown in. Also, because the Internal Revenue Service allows investors operating on Indian land to accelerate the depreciation of investments, the Chickasaws' partners will benefit, too. The state's economic officials are backing the tribe because the project is expected to create 500 jobs—mostly for non-Indians.

'WE JUST COULDN'T COMPETE'

BUT INCREASINGLY the tribes are at loggerheads with their home counties and states, which have been going to court to fight Indian attempts to take large tracts of land off local tax rolls. One of the legal epicenters is central New York. There the Oneidas have parlayed the proceeds from their Turning Stone casino into five golf courses, two marinas, over 700 hotel rooms, an RV park, an animation production company, a national weekly newspaper called *Indian Country Today*, and a string of gas stations.

In some cases, the Oneidas' expansion

has helped drive traffic to nontribal businesses. In others, say locals, the tribe's actions have put rivals in jeopardy. Fastrac Markets, a chain of convenience stores, found itself unable to compete with Oneida gas stations selling cigarettes and gasoline tax-free. After sales dropped by half at some locations, it says, Fastrac decided to sell four stations to the tribe. "Nobody likes to raise the white flag," says Fastrac's vice-president for sales, John D. Lytwynec. "We just couldn't compete."

In recent years the Oneidas have bought up 17,000 acres within a 10-mile radius of the original reservation. They are opening hotels and convenience stores, and declining to pay taxes. The local authorities, fearful of losing much-needed revenue, have taken the tribe to court. In 2005 the U.S. Supreme Court ruled that the Oneidas had to pay property tax on land they had acquired in Sherrill, N.Y., a hamlet of some 3,000 people about five miles from the casino.

Now the tribe is asking the Bureau of Indian Affairs to put all the newly acquired land in trust. Oneida and Madison Counties oppose that. But the BIA's new chief, Carl Artman, an Oneida from Wisconsin who was named to the post on Mar. 6, has

vowed to approve quickly some 2,000 land-in-trust applications. (A spokesperson says Artman will recuse himself from decisions involving Oneidas.)

Local businesses complain that Congress isn't doing enough to restrain the tribes' power. Dan Gilligan, president of the Petroleum Marketers Assn., which represents gas stations, has tried for years to get Congress to pass a law forcing tribes to pay the same state gasoline taxes as other operators. "Congress didn't want to tackle a Native American issue," he says. "There are very few entities that raise more political money than Native Americans."

Oneida Chief Executive Halbritter says it's important to remember how much tribal businesses help local and regional economies. He adds that griping about unfair competition is sour grapes from businesses that would have failed anyway. Halbritter also notes that local governments often extend tax breaks to lure new businesses that create jobs. "For all the years we lived in poverty we had no complaints," he says, "until we got successful." Still, the tribes find themselves under increasing pressure to operate just like everyone else. ■

A New Stack of Chips

Gambling has been a huge revenue source for many Indian tribes, but some are looking beyond casinos to all kinds of new investments.



TOURIST ATTRACTIONS

Arizona's Hualapai Indians are opening a glass-bottomed skywalk that juts 70 feet into the Grand Canyon on their portion of the canyon's western rim. Admission: \$25. The development has angered nature lovers who would prefer not to see the canyon spoiled. Former astronaut Buzz Aldrin will take the first steps on Mar. 20.



THEME RESTAURANTS

The Seminole Tribe of Florida agreed to pay \$965 million to purchase the Hard Rock restaurant chain in December, complementing their two wildly successful Hard Rock casinos. The tribe will run it as a taxpaying corporation. Announcing the deal in New York's Times Square, tribal representative Max Osceola Jr. said: "We are going to buy Manhattan back, one burger at a time."



SPORTS CARS

Oklahoma's Chickasaw Nation hopes to resurrect the MG sports car in a partnership with China's Nanjing Automobile Group. The tribe has purchased a quarter of an industrial park and applied to put it in federal trust. By locating on Indian land, the enterprise avoids property and inventory taxes and can accelerate depreciation of its investment. Cars are expected to roll out of the plant by fall of 2008.

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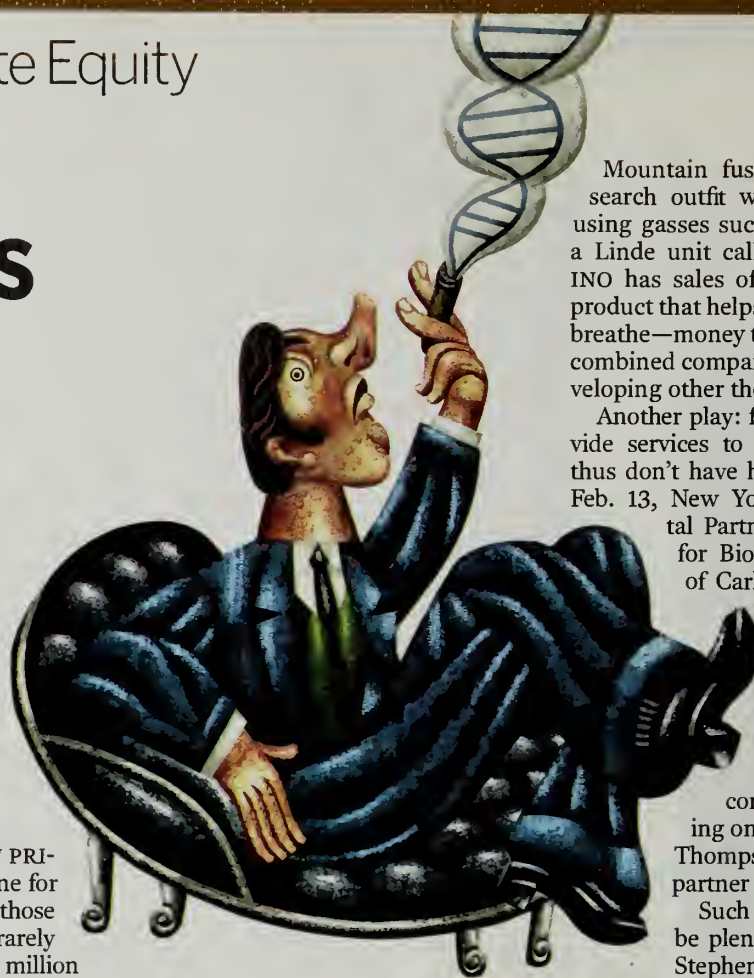
Biotech's Unlikely New Pal

Can private equity manage its big risks and far-off returns?

BY ARLENE WEINTRAUB

IN AN ERA OF \$45 BILLION private equity deals like the one for energy giant TXU Corp., those worth less than \$1 billion rarely merit a mention. Yet a \$670 million deal on Feb. 22, led by New York private equity firm New Mountain Capital, is a milestone in the cash-starved world of biotech. The foray, which merges Seattle-based Ikaria Inc. with a spin-off of Germany's Linde Group Inc., marks one of the biggest moves by private equity in the sector—and signals that more may be in the works.

At first blush, private equity and biotech make for an odd marriage. The biotech industry is famous for unstable cash flows and massive research-and-development budgets that produce many more flops than blockbusters. Private equity players aren't known for their patience, either, and successful drugs often take decades to come to market. No amount of financial engineering can speed up the science. Still, some private equity players think they can earn big returns in the sector, even though it means investing in R&D. Says



Bryan Roberts, managing general partner at Venrock Associates, a Menlo Park (Calif.) venture capital firm involved in the Ikaria deal: "[Private equity is] buying into the vision of biotech."

Part of that vision may be recognizing a potential exit strategy: Big Pharma buying their biotech assets. The big boys are running head first into a crisis as more than 70 major drugs lose their patent protection in the next few years, including Pfizer's cholesterol reducer Lipitor and BristolMyersSquibb's blood thinner Plavix. That could leave a potential hole of up to \$100 billion in lost sales by 2011. So some stalwarts are making huge bets on tiny biotechs. Last October, Merck & Co. paid \$1.1 billion (a 100% markup from market value) for Sirna Therapeutics Inc., a public company with just \$5 million in sales. Its most advanced project is still in early testing.

So far private equity is going after businesses that have a steady cash stream or finding ways to create new flows. That's why New

Mountain fused Ikaria, a pure search outfit working on treatments using gasses such as nitric oxide, with a Linde unit called INO Therapeutics. INO has sales of \$160 million from a product that helps critically ill newborns breathe—money that will help the new combined company offset the cost of developing other therapeutic gasses.

Another play: finding outfits that provide services to biotech scientists that thus don't have huge research tabs. On Feb. 13, New York-based Avista Capital Partners paid \$210 million for BioReliance Corp., a unit of Carlsbad (Calif.)'s Invitrogen Corp. that provides safety testing and other services for 600 biotech and pharma outfits. "They're doing critical functions for other companies but not trading on the product risk," says Thompson Dean, a managing partner at Avista.

Such biotech treasures could be plentiful for private equity. Stephen Evans-Freke, managing general partner of Celtic Pharmaceutical Management, a private equity firm specializing in the sector, estimates that half of biotech's 300-or-more publicly traded companies have a market value less than \$250 million—size that makes it tricky to raise extra cash. On top of that, there are 1,000 or more privately held biotech enterprises, many of which

have been struggling to pull off a public offering since the 2001 market crash. A number of companies are all dressed for an IPO party," says Evans-Freke. "There's no party to go to."

With little respect from the public markets these days, some biotech companies are welcoming private equity. Australia's Peptech Ltd. banked \$17 million in sales in 2006 and figures royalties from its technology should rev up revenues by \$100 million more over the next few years. Even while its stock is languishing on the Sydney exchange, Peptech has piqued the interest of some U.S. private equity firms. Says its chief executive, Dr. John C. Chiplin: "If the public markets won't value Peptech fairly, maybe the private markets will." ■

Strange Bedfellows

Private equity isn't a natural fit for biotech, but some firms are making it work.

TRADITIONAL THINKING

- Issue massive debt
- Avoid R&D investment—the payoff's too long-term

NEW THINKING

- Fund selective R&D
- Combine R&D outfits with moneymaking enterprises

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How Secure Is Your Domain?

Problems at RegisterFly.com shed light on loose oversight of Net addresses

BY STEVE HAMM
AND MEGAN TUCKER

WHEN KEVIN MEDINA and John Naruszewicz joined forces nine years ago, the Internet was like an untamed frontier.

There was little to discourage Medina, the owner of an office-cleaning business in New Jersey, and Naruszewicz, a recent high school dropout, from joining the dot-com gold rush. The tiny company they started, RegisterFly.com Inc., ultimately became a midsize registrar of Internet addresses for more than 200,000 customers, including entertainer Michael Jackson. Now a messy fight between the two for control has brought RegisterFly to its knees and prompted angry calls for better oversight of the Web registry industry.

The RegisterFly.com saga sheds light on a little-understood but vital corner of the Internet. Domain-name registrars receive fees from individuals and businesses to record Web names that start with "www" and end with ".com," ".net," or the like. The registration industry has grown at a gallop, from 145 players in 2000 to more than 860 last year. Many operate smoothly, charging a few dollars to register new names, renew annual registrations, or transfer them, then pass that information on to a handful of registries that keep master lists of names.

But some unruly outfits have also appeared, while the industry goes virtually



unregulated. "We need to tame the wild west and bring control and regulation to this business," says Sam Flanders, president of 2wmc.com Consulting Group Inc. and a RegisterFly.com customer.

After months of customer complaints about poor service, RegisterFly's problems came to a boil in February when Naruszewicz and another company director fired Medina as chief executive. They

accused him of stealing from customers to pay for luxury cars, a penthouse apartment in Miami's posh South Beach, and a liposuction operation. Medina, who denies the accusations, regained the helm on Mar. 9 after a U.S. District Court judge ruled that he was the sole owner. But in the meantime the company Web site was operating fitfully.

Some 75,000 customers had lost control of their domain names, according to a court filing. Many are trying to transfer their accounts to other registrars, but haven't been able to get RegisterFly to respond.

'TRAIN WRECK'

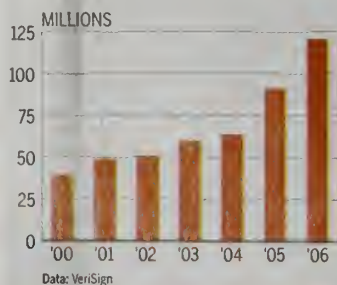
REGISTERFLY CUSTOMERS aren't just mad at the company. They fault the International Corporation for Assigned Names & Numbers (ICANN), a private nonprofit organization sanctioned by the U.S. and other nations to accredit registrars, for not moving fast enough to investigate and take action. It was only after a year of eroding service that ICANN on Feb. 2 threatened to revoke RegisterFly's accreditation. "ICANN knew what was going on, they waited and let the train wreck happen," says Philip J. Corwin, counsel for the Internet Commerce Association, which represents companies that own domain names.

ICANN insists it acted as quickly as possible. Until February, the organization lacked evidence that RegisterFly had violated its contract with ICANN by failing to pay fees and by replacing the names of the registrars with Kevin Medina's name, according to ICANN. The group gave RegisterFly a deadline of Mar. 14 to set things right or face de-accreditation. But ICANN, based in Marina del Rey, Calif., has limited powers. The U.S. Commerce Dept. asked ICANN to monitor the operations of registrars, but to oversee customer service complaints.

Still, the organization sees the RegisterFly mess as a call to action. Peter Twomey, ICANN's chief executive, plans on proposing reforms at a meeting of ICANN's board and interested parties in Lisbon during the week of Mar. 26. One thing, he would like ICANN to have more say over the activities of companies downstream from the registrars, known as resellers, who also sell domain names. RegisterFly was a reseller until it became a registrar in its own right last year. Twomey also favors establishing a training-certification regime for registrars. These would be the first significant reforms for ICANN since it was established in 1998. ■

THE WEB TAKES OFF

Registration of Web site domain names has soared since 2000



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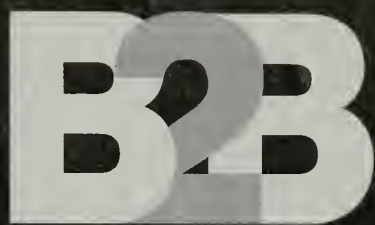
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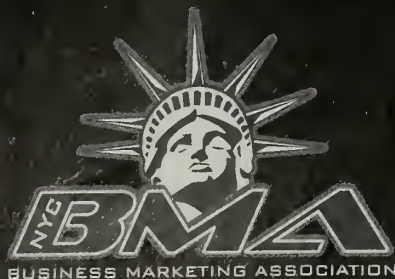


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Celestial Sightseeing

Astro tourism—to glimpse eclipses, meteor showers, and comets around the planet—is taking off. **BY KATE MURPHY**



DURING A TOTAL SOLAR ECLIPSE THE SKY turns dark blue and sunlight casts ripples on the ground as if it were the bottom of a swimming pool. Birds return to their roosts even though it's daytime, and the horizon flames orange-red. "It's so powerful, people start gasping and crying," says Jeffery Keffer, a lawyer from Arlington, Mass., who has traveled to the South Pole, Panama, Egypt, and South Africa to see the moon temporarily obliterate the view of the sun.

Celestial happenings such as eclipses, meteor showers, and comets have fostered a growing branch of travel called astro tourism. Participants range from space enthusiasts toting their own telescopes to novices who think the Corona Borealis is a beer.

Several companies specialize in astronomy travel. One of the best known is TravelQuest (tq-international.com), which partners with *Sky & Telescope Magazine* to set itineraries. Astronomers who write for the magazine accompany the tours, giving lectures and helping travelers sight stars and planets through telescopes. "In putting together trips, we try to find unique places to view" celestial events, says J. Kelly Beatty, executive editor of *Sky & Telescope*. He led a trip to Libya to see last year's solar eclipse soon after the country opened to Western tourists.

That same eclipse gave Keffer and his wife, Sue, a reason to go to Egypt. They viewed it from a high plateau overlooking the Mediterranean. "The corona was particularly stunning with orange tongues...spinning out from the edges," Keffer said. He and the others in his group wore Mylar glasses so they could safely look at the sun, and they toasted with champagne when it was over. The eclipse lasted about two hours. Also part of the trip were more typical excursions to the Sphinx and Pyramids in Giza as well as a Nile cruise to see the ruins and museums in Luxor, Aswan, and Abu Simbel.

ABOVE THE CLOUDS

BECAUSE TOTAL SOLAR eclipses occur rarely and can be observed only in a narrow geographic area, tours to see them usually book up a year or two in advance. The next total solar eclipse is in August, 2008, when the moon's shadow will start in northern Canada, skirt the edge of Greenland, track through central Siberia, and end in northwest China. Most tours to view the event are to China and Russia. Costs range from \$3,000 to \$10,000, depending on the duration of the trip and type of accommodations.

Several tour operators are also of-

fering cruises on icebreakers that will sail through Arctic waters to view the eclipse. Cabins for two start at \$23,000. In addition, TravelQuest has chartered an Airbus A330 to fly to the North Pole for a look at 30,000 feet. All business-class seats have sold out at \$13,380 each, but economy tickets for \$4,440 to \$10,800 are available. In 2003 the company chartered a plane to the South Pole to see an eclipse. "It was spectacular," says David Bloomfield, a corporate financial controller in Fair Lawn, N.J., who was on the flight. "From that high up you don't have to worry about clouds obscuring your view."

If you can't wait until 2008, lots of tours are scheduled in the meantime. MWT Associates (melitatrips.com) has a trip in August to an observatory in the Atacama Desert in Chile (\$3,600), where you can view the sky through giant telescopes. TravelQuest has a trip to Iceland in October to see the Aurora Borealis (\$2,750).

If you're not one for tours you can always visit Mauna Kea on the island of Hawaii (ifa.hawaii.edu/mko/visiting.htm). At 13,800 feet, it's the highest point on all the Hawaiian islands and home to the world's largest astronomical observatory, with 13 working telescopes. The barren, volcanic terrain gives you a sense that you've traveled to another planet. Free stargazing programs led by the observatory's astronomers are held every night from 6 p.m. to 10 p.m. Or you can check out two New Mexico astronomy retreats: the Starhill Inn (starhillinn.com) in Sapello or New Mexico Skies (nmskies.com) in Cloudcroft. Both have cozy cabins, state of the art equipment for viewing and photographing, and astronomers on hand. It's a vacation that will put stars in your eyes.

(CLOCKWISE FROM TOP) ROGER RESSMEYER/CORBIS; AARON HOROWITZ/CORBIS; TOM WALKER/GETTY IMAGES

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The Airport Gourmet

Great airport food is no longer an oxymoron. Many terminals worldwide are supplementing their fast-food courts with local and gourmet fare. Here are five that are (almost) culinary destinations in their own right. **BY GREG LINDSA**

AMSTERDAM SCHIPHOL

As one might expect in this maritime nation, fresh fish is the main attraction. The Shirasagi Sushi Bar was one of the first to offer raw fish in an airport, and the tiny stand offers some of the best outside of Tokyo Narita International Airport. If you've just won big betting on roulette at the in-transit casino, celebrate with champagne, caviar, and oysters at Bubbles, surely the chicest airport bar in the world.



AMSTERDAM

BOSTON

LOGAN INTERNATIONAL
Passengers hankering for a lobster roll—or who are suddenly struck with the idea to make a fresh one at home—have options here. In Delta's new Terminal A, Jasper White's Summer Shack offers the classic on a toasted roll with fries. Also on the menu: lobster

corn dogs, fried clam rolls, and a full raw bar. But if it's a live lobster you're looking for, Anthony's Pier 4 in Terminal B will pack one that should survive 48 hours in transit.

DALLAS/ FT. WORTH INTERNATIONAL

The rings of DFW's older terminals are a succession of T.G.I.

Friday's outlets, but its gleaming two-year-old international Terminal D offers a last taste of authentic Tex-Mex before your flight. Hop the post-security "Skylink," then choose among outposts of Dallas favorite Cantina Laredo, Fort Worth institution Reata Grill, and Blue Mesa Taco & Tequila Bar from both Fort Worth and Big D.

HONG KONG INTERNATIONAL AIRPORT IN CHEK LAP KOK

As Asia's busiest crossroads, it's no surprise that Chek

Lap Kok has offerings to tickle every palette. For authentic local fare, try Maxim's Chinese restaurant with such Cantonese favorites as shark's fin soup and braised abalone. Hang Heung's Kitchen offers steamy wonton noodles in a traditional setting with carved wooden dividers and jade stools, while Ah Yee Leng Tong serves excellent dim sum with a front-row runway view. There's even good Italian food, at Grappa's Bar & Italian Restaurant.

SEATTLE- TACOMA INTERNATIONAL

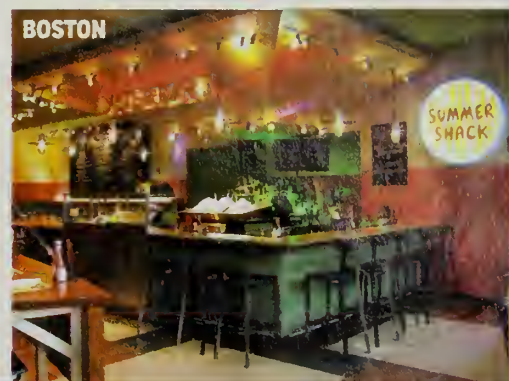
The "Pacific Marketplace" in SeaTac's new central terminal is another home for Anthony's, a local family of eateries with a devotion to the freshest of fish. The airport's branch offers oysters on the half shell just dredged from Puget Sound, Alaskan King salmon, and the house specialty blackberry cobbler. If fish and chips is more to your taste, visit Ivar's Seafood Bar, an incarnation of the city's favorite chip shop. Seattle chef Kathy Casey also sells take-out fare from two Dish D'Lish cafés. ■

—With Frederik Balf

BusinessWeek .com

ONLINE: For a poll on airport food, go to businessweek.com/extras.

TELEVISION: To see dishes from airport restaurants, watch *BusinessWeek Weekend*. Check local listings or go to businessweekweekend.com.



BOSTON



SEATTLE



BY ROBERT PARKER

California Pinots To Rival Burgundies

PINOT NOIR, THE GRAPE that makes the red Burgundies of France so famous and cherished, is a delicate fruit that's hard to grow and make into drinkable wine. But some Californians, in Sonoma's cool Russian River region and in more southern reaches as well, manage to produce great wine from it. Their efforts are pricey, \$40 to \$75 a bottle, and hard to find except at top wine shops and restaurants. That's why, if you're interested in purchasing them, you should get on the mailing lists of wineries that catch your eye.

Ambullneo Vineyards, Santa Barbara

A newcomer with an impressive portfolio of three pinot noirs, all from the area just north of Santa Barbara, Ambullneo looks like it will be a serious player in the years ahead. 805 474-5678

Calera, Mt. Harlan

This Monterey County winery is one of the pioneers of single-vineyard Burgundy-styled pinot noir. While most California pinot is meant to be drunk young, Calera's has an uncanny track record of aging well for 10 to 15 or more years. 831 637-9170

DuMOL, Russian River Valley

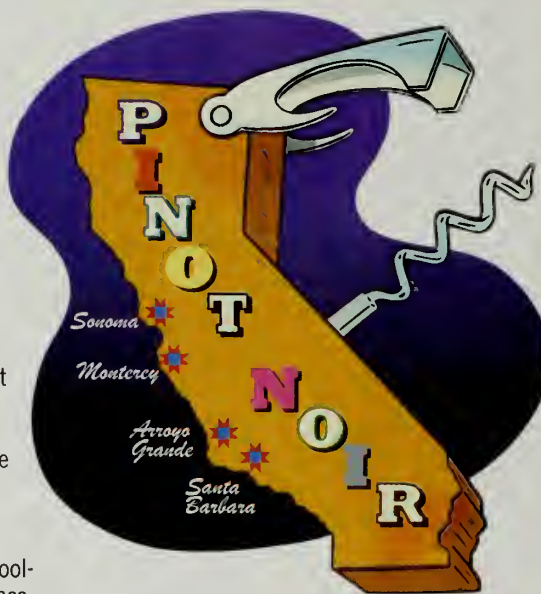
Exquisitely rich pinots from different cool-climate sites emerge from this high-class winery. They are intense wines that age beautifully. 925 254-8922

Hartford Court, Russian River and Sonoma Coast

This very serious winery is owned by Don Hartford and Jess Jackson, who is one of the largest vineyardists in California. It makes wonderfully perfumed and velvety wines meant for drinking in their first five or six years of life. 800 588-0234

Kistler, Russian River Valley

Proprietor Steve Kistler has increasingly



moved his pinot noir production farther and farther west, seeking cold-climate hillsides to bring out the grape's complex aromatics and delicate flavors. 707 823-5603

Marcassin, Sonoma Coast

Marcassin was one of the first Sonoma Coast premium producers with vineyards that have a full ocean view. The highly regarded winemaking consultant Helen Turley has been the guiding force behind its pinot noirs, which are the wines of an uncompromising perfectionist. 707 942-5633

Martinelli, Russian River and Sonoma Coast

The Martinelli family, known in many circles for their apples, have some of the finest pinot noir vineyards in the Russian River and Sonoma Coast regions. From their vines come full-bodied, flavorful, and intense wines that age handsomely for up to a decade. 707 525-0570

J. Rochioli, Russian River

The Rochioli family is another family that has farmed the Russian River for decades. Their single-vineyard pinot noirs are among the best in the world. 707 433-2305

Talley Vineyards, Arroyo Grande Valley

Talley is a huge farming operation known locally more for avocados than for grapes. Their single-vineyard pinot noirs are exceptional. 805 489-0446

Roar Vineyards, Santa Lucia Highlands

Roar is a rare success story when it comes to producing world-class, rich pinot noirs from the slopes of the Monterey County's Santa Lucia Highlands. You're going to hear a lot more about Roar. 831 675-1681

Robert Parker is the world's most influential wine critic. Visit eRobertParker.com to see thousands of tasting notes, buy his books, subscribe to his newsletter, The Wine Advocate.

For more Parker picks, go to www.businessweek.com/extras.



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The Wisdom Of Brackets

Breaking complex questions into binary steps can lead to smarter calls. **BY JEFFREY M. LADERMAN**



CLARK WINTER
Master of
the brackets

NOW THAT YOU'VE filled in your brackets for this year's March Madness, why stop with basketball? The same process you use to pick Boston College over Texas Tech or Indiana over Gonzaga has applicability to questions that go far beyond which team will be the national champion. Such is the point of *The Enlightened Bracketologist: The Final Four of Everything* (Bloomsbury USA, \$15.95), a new book edited by Mark Reiter and Richard Sandomir.

The brackets structure forces you to organize and focus your thoughts. "The smartest executives and the most successful investors have a unique ability to process an enormous amount of information and boil it down into bina-

ries—'yes or no' is a binary—that simplify decision-making," says Clark Winter, global chief strategist for Citigroup Global Wealth Management. Winter's investment strategies bracket is one of 101 in the book, which attempts to identify the best of everything from cheeses to talk show hosts to CEOs (that last one contributed by *BusinessWeek* Executive Editor John A. Byrne).

The bracket shown here has been adapted and updated from the one Winter created for the book. In each matchup, the strategist is making a decision about which will be the better-performing asset class, given his cautious view of the global investment scene. "The sentiment has shifted from greed to fear," says Winter. How does that figure in deciding investments? Winter opted for U.S. mid-cap stocks over U.S. small-caps because the mid-caps are more mature companies with more market liquidity. But in a subsequent round, derivatives beat mid-caps because they offer specific protection or targeted participation in the market.

Winter uses 32 categories, many familiar to individual investors and others, like the carry trade (borrowing low-interest-rate currencies to purchase high-rate currencies), mainly practiced by the pros. But you can pare it down to 16 or even 8 competitors. It's the process that counts, not the number. Winter explores investment decision-making further in his own book, *The Either/Or Investor*, to be published by Random House in May. ■

WHAT'S THE INVESTMENT A MOM

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High-rated U.S. Corporate Bo
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deliberation and some randomness. Then he weighs each matchup, deciding which is the better investment, the winner of which goes on to the next round, and so forth. This bracket is adapted from one Winter prepared for

1 EVENT-DRIVEN HEDGE FUNDS BEAT CASH. Interest rates are still relatively low, which makes cash unattractive. Event-driven hedge funds, which invest in companies whose fortunes are influenced by events such as mergers, regulatory changes, or even hurricanes, can make money in up or down markets.

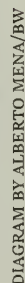
2 DERIVATIVES BEAT U.S. MEGA-CAP STOCKS. Financial derivatives such as put and call options and structured products give you a way to protect an investment or targeted participation—for example, an option on a specific stock or index. Making money in mega-caps, on the other hand, depends on a broad market upswing.

3 METALS BEAT OIL AND GAS FUTURES.

Energy prices will bounce around, but they've contributed about all they're going to for this market cycle. With the rise of China, India, and other emerging countries, the underlying demand for industrial metals is in an enormous long-term uptrend.

4 JAPANESE EQUITIES BEAT LATIN AMERICAN EQUITIES. The rising yen is a reflection of an improving economy, an important reason to own Tokyo stocks. Latin American equities, while better values than Asian stocks (except Japanese issues), have their problems, not the least of which is a resurgent radical left in several countries.

5 GLOBAL REITS WIN ALL. Real estate investment trusts, well developed in the U.S., are a relatively new vehicle everywhere else. They allow owners to securitize their holdings and raise funds for new projects and give investors stock-like ownership in a portfolio of properties. U.S. REITs have been on a roll for six years, and bargains are few. The global real estate boom, on the other hand, is just getting started.





Overlooked And Underpriced

Preferred stocks—part stock, part bond—can be worth the extra effort they demand. **BY LEWIS BRAHAM**

PREFERRED STOCK: IT'S an often-ignored, misunderstood investment, and because of that there's an opportunity for income-seeking types. These hybrid securities, which trade like stocks and pay income like bonds, offer higher yields than bonds of comparable credit qualities and have lower default rates. Better yet, many qualify for the 15% maximum tax on dividends, vs. the 35% maximum tax on corporate bonds.

In stormy markets preferreds can even be a safer harbor than bonds. "They are bought mainly by buy-and-hold investors, whereas institutions buy corporate bonds and trade them ac-

tively," says Richard Lehmann, publisher of newsletter *Forbes/Lehmann Income Securities Investor*. "So preferreds don't have the selling pressure bonds do when rates go up."

The big knock on preferreds is the scarcity of information on them. They are so far off Wall Street's beaten path that brokerage firms don't even use the same

ticker symbols for them. Usually initial letters are the same, but the suffix identifying it as a preferred changes.

More information and analysis is coming available. QuantumOnline.com free site, makes it easy to screen preferreds by different characteristics, such as crating, coupon payment, or tax status. \$295 a year, PreferredsOnline, at preferreds.com, has much the same information but with better screening tools: real-time prices. Lehmann's newsletter offers individual preferred picks and five model portfolios. The annual cost is \$1.

Before you buy any preferred stock check if the issue is "cumulative" or "noncumulative." Companies sometimes get into a cash crunch and omit dividends. With cumulative shares the company must make good on missed dividends. Noncumulative preferreds do not have that feature.

Although there are opportunities in U.S. preferreds, Lehmann is finding better plays in issues of foreign companies. The A-rated foreign preferred of Royal Bank of Scotland, which at \$25 yields 6.16%, is a "perpetual preferred" without a set maturity date. That means it has fixed cumulative dividends and no call date—when the company may as well buy it back (table).

Opportunities also lie in third-party trust preferreds. Typically issued by large brokerages such as Merrill Lynch or Morgan Stanley, these preferreds are actually corporate bonds the broker deposits in a trust. With names such as CorTs, COS, SATURNS, and PPLUS, they are often hard to understand and consequently underpriced. One of Lehmann's favorites is Merrill Lynch's Depositor Preferred Trust Series TWC-1, which holds bonds issued by media giant Time Warner. It yields 6.06% at the current price of \$24.75.

If individual issues seem daunting, consider an exchange-traded fund, such as PowerShares Financial Preferred Portfolio, or a closed-end fund, such as BlackRock Preferred Income Strategies Fund. BlackRock's yield is high because shares trade at a discount to their net asset value. Closed-ends often do. A fund also uses leverage, which increases risk. But the extra yield could make it a smart bet. ■

Ways to Play Preferreds

Stock/Symbol*	Price**	Yield**
ALABAMA POWER ALP-N	\$24.33	5.34%
PPLUS TRUST SERIES TWC-1 PYI	24.75	6.06
ROYAL BANK OF SCOTLAND SERIES M RBS-M	25.99	6.16
Exchange-Traded Fund/Symbol		
BLACKROCK PREFERRED INCOME STRATEGIES PSY	20.69	6.67
POWERSHARES FINANCIAL PREFERRED PORT. PGF	25.07	5.38

*Symbols may vary at different brokerages

**Mar. 12, 2007

Data: QuantumOnline.com, Yahoo! Finance

BusinessWeek .com

To see a video report on investing in preferred shares and other high dividend stocks, go to www.businessweek.com/go/tv/preferred.

How to Make a Deal Bloom

As the spring shopping season approaches, the housing market is in turmoil. For buyers, this is a time to negotiate. If you're a seller, you may need to adjust your expectations. Here are timely tips for those on both sides of the contract. **BY CHRISTOPHER PALMERI**



FOR SELLERS

GET ON THE NET More than 80% of shoppers check out home listing sites such as Realtor.com before they buy. Make sure your sales agent has at least six good photos of your home and a video tour online. "Listings with six photos get almost 100% more viewers than those with single photos," says Carol Samuelson, president of Realtor.com.

SPRUE UP THE HOUSE Everybody's watching the home makeover shows these days. Hiring a designer to spruce up your home can cost as little as \$150 for a consultation, says Denver home stager Lynn Hodges. For a few hundred more, he'll bring plants, modern art, and furniture. Your sales agent will often pick up the tab.

DON'T OVERPRICE Developer Robert Sheridan tried everything from free kitchen upgrades to financing incentives to move condos at his Lakeshore at Andersen Springs complex in suburban Phoenix. What worked: slashing prices by 10%. "People are looking over their shoulder at what their neighbor sold for a year ago," he says. "That's not the market today."

GO GREEN Environmentally friendly features are in, especially if buyers don't have to pay for them. You can give your home a green sheen inexpensively by replacing incandescent bulbs in light fixtures with energy-saving compact fluorescent ones. Put filters on the faucets and a compost bin in the backyard.

DON'T FORGET ABOUT AS IS Do some fixing on your fixer-upper. Replace old kitchen and bathroom fixtures, wallpaper, mirrored glass, paneling, and other accoutrements of bygone design with more contemporary looks. Paint walls taupe, not white.



FOR BUYERS

SELL YOUR HOME FIRST Put your current house on the market before you go looking for a new one. Properties are taking longer to sell, notes Phyllis Haber, an agent with Prudential Douglas Elliman in Huntington, N.Y. If you find your dream house before you unload your old one, "unless you can carry two mortgages, you may lose a deal."

RESEARCH COMPARABLE PRICES To get the latest sale prices for similar properties in the neighborhood you're looking in, ask your real estate agent for recent sales data from the multiple listing service. Home appraisal sites such as Zillow.com that rely on deed or mortgage filings can be a few months behind.

BE REALISTIC ABOUT PRICE Lowball offers turn off sellers, and negotiating from there could get contentious. Make an offer of no more than 10% below the asking price if the home is already fairly priced, says Mark Nash, author of *1001 Tips for Buying and Selling a Home*. Then ask for concessions, such as having the seller pay closing costs.

DON'T WALK AWAY IF THE SIGN SAYS "SOLD" New-home builders are experiencing cancellations, so it pays to keep in touch with the salespeople. Jim Widner, a general manager at builder KB Home, says a buyer in Las Vegas recently snagged a model that was in short supply after receiving a text message from a salesperson saying it was available again.

PUT YOUR FINANCIAL HOUSE IN ORDER Before shopping for a mortgage, order free copies of your credit reports at annualcreditreport.com. Don't rush to cancel old credit cards. Having a long history can improve your credit score.

BusinessWeek weekend TELEVISION: For more buying and selling tips, watch our weekly TV show. Check your local listings or go to businessweekweekend.com.



BY GENE G. MARCIAL

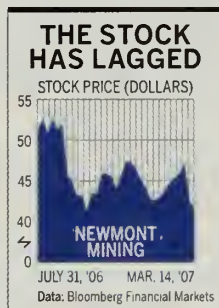
NEWMONT'S ASSETS COULD LOOK GOOD AS GOLD TO BARRICK.

IN TIGHT-MONEY TIMES, CB RICHARD ELLIS IS ON SOLID GROUND.

REPAIRING OIL WELLS IS KEEPING SUPERIOR ENERGY BUSY.

Newmont May Gleam

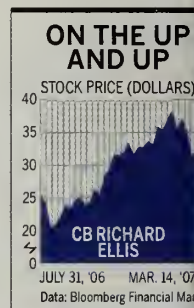
GOLD HAS BEEN SHOWING ITS METTLE. The price has vaulted from \$541 an ounce a year ago to \$650 on Mar. 14. The “bugs” say gold is still the best metal to own for the next 12 to 24 months. But which producers will shine brightest? Newmont Mining (NEM), the world’s No. 2 producer, “is the one,” says Vincent Carrino, chief of Brookhaven Capital Management, which has loaded up on its stock. “It gets the full impact of rising gold spot prices because it hasn’t hedged its output,” he notes. No. 1 Barrick Gold, however, did so—and hasn’t benefited as much. Some pros think Barrick may go after Newmont for its proven and probable reserves of 95 million ounces. It has operations worldwide—in Australia, Canada, Mexico, and the U.S. Barrick overtook Newmont as No. 1 when it acquired Placer Dome in March, 2006, boosting its gold reserves to 138 million ounces. With Newmont, Barrick would hike them further. Both companies also produce copper. Newmont’s stock is down from 60 last May to 41.44 on Mar. 14. In a deal, Newmont would be priced in the mid-50s, say the pros. With demand still high, analysts predict gold prices will keep climbing. At Newmont, cost pressures remain a problem, and costs are expected to spike 25% in 2007, says Michael Fowler of Desjardins Securities, who rates it a buy, with a 12-month target of 67. He sees profits of \$2.70 a share in 2007 vs. 2006’s \$1.76. Barrick “is always on the lookout” for companies that would provide synergies, spokesman Vince Borg said, but wouldn’t comment on Newmont. And Newmont didn’t return calls.



Why CB Richard Ellis Could Be a Good Bet

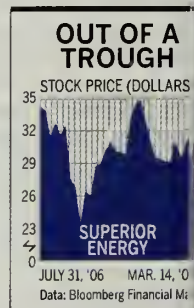
FOLLOW THE FED is a strategy that Douglas Roberts uses in picking stocks at Channel Capital Research Institute, where he is managing principal. Simply put, you should buy mid-to-large-cap stocks when the Federal Reserve Board is in a tight-money mode, and go for small caps when it eases on interest rates. Roberts is opting for big-caps, as he doesn’t see the Fed cutting rates soon. Among his top choices: global real estate services outfit CB Richard Ellis Group (CBG). It helps with property leasing, sales, and

valuation (page 72). CBRE benefits from the expanding global real estate business—on the rise or not—since its services are needed in any deal, says Roberts. Up from 20 in August to 32.21 on Mar. 14, CBRE is cheap based on consensus estimated profits of \$1.98 for 2007 and \$2.37 for 2008, he says. Brandon Dobell of Credit Suisse rates CBRE “outperform,” with a 12-month target of 44.



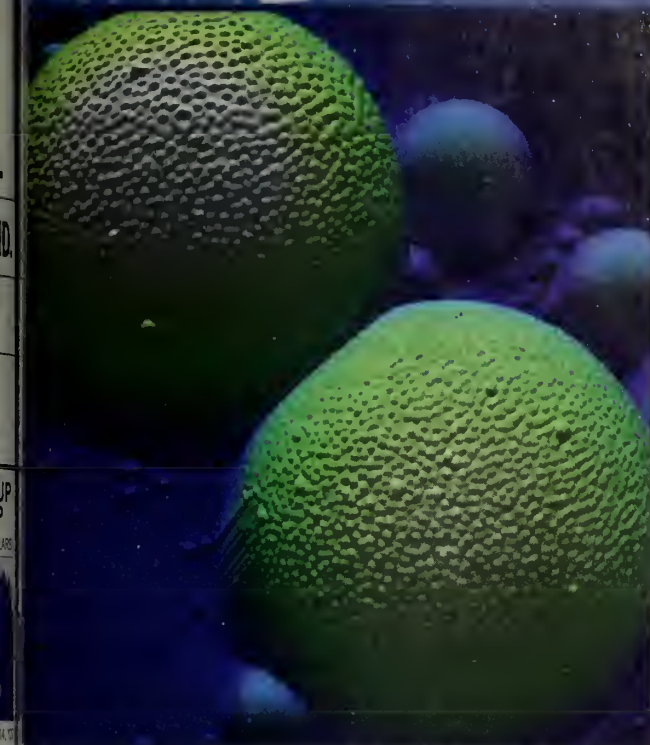
‘Tremendous’ Demand for Superior Energy Services

SUPERIOR ENERGY SERVICES (SPN) aims to be everything to oil-and-gas explorers in the Gulf of Mexico and in most cases it is. One specialized service is “well intervention.” It repairs and maintains onshore or offshore wells that are old or have been badly damaged by violent weather like Hurricane Katrina. “Superior can’t keep up with the tremendous demand for its repair and recovery services, which will provide strong growth through the end of the decade,” says Martin Sass, CEO of MDSass, which manages assets of more than \$10 billion and owns a 1.2% stake. Superior also buys wells that the major oil companies abandon, resuscitates them, and keeps them in its own oil-and-gas unit. Sales and earnings have risen since 2001 when it earned 30¢ a share. By 2006 earnings had rocketed to \$2.32. Its stock, up from 23 last Sept. 25 to 33.23 on Mar. 14, is selling at a 35%-40% discount to its peers, notes Sass. In the Gulf of Mexico, Superior has 56% of the business, but that figure may decline this year as the company pushes expansion elsewhere including the Middle East, North Sea, and Venezuela, says Sass. Stewart Glickman of Standard & Poor’s, who rates Superior a “strong buy,” sees profits in 2007 rising to \$3.42 share and to \$4.13 in 2008. ■



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ONLINE: Gene Marcial’s Inside Wall Street is posted at businessweek.com/investor at 5 p.m. EST on the magazine’s publication day, usually Thursday. **Note:** Unless otherwise noted, neither the sources cited in Inside Wall Street nor the firms hold positions in the stocks under discussion. Similarly, they have no investment banking or other financial relationships with them.



LEFT: Nanoscience is unraveling what makes colloids self-assemble into building blocks for hundreds of common items such as aerosols, gels, inks, detergents, even polymers and proteins. View is 50-micron scan. (Atomic Force Microscopy image taken on an Asylum Research microscope at NIST. Courtesy: Asylum Research)

about 100 nanometers. Experts say if we can understand and manipulate our world at this tiny scale, we'll unlock a vault brimming with discoveries and promise.

Nanotech Holds Medical Promise. A DNA molecule is 2.5 nanometers wide. The National Cancer Institute and National Institutes of Health are investing in nano-research to find better ways to diagnose and treat cancer. NCI/NIH are working on cell-sized nano-containers to deliver gene therapy, quantum dots to find tumors only a few cells wide, and even custom-designed drug therapies based on a patient's DNA.

"There is a lot of exciting nanotechnology research in the lab now and the goal is to get it into clinical trials," says Dr. Mansoor Amiji, a Northeastern University nano-researcher investigating therapies for childhood cancers. Small biotech, such as Abraxis Bioscience, have already received FDA approvals for drug nano-formulations. And Genentech is joining other larger biotech in nano R&D.

Nanotech Fueling "CleanTech" Revolution. The Nano Science and Technology Institute (NSTI) is at the center of the nanotech-clean-tech convergence. "There is a burst in nanotechnologies aiming to cut pollution, waste and energy use for industrial firms," said Dr. Matthew Laudon, NSTI's Executive Director.

Laudon notes many examples. NanoH₂O (Santa Monica, CA) has nano-membranes to improve water reclamation and desalination. The University of Wisconsin is working on nano fuel cells for cellphones, PDAs and TV. "Smart batteries" from nanotech designs will store power for years and release current on-demand. Nano-thin roll-printing will make solar cells cheaper. NSTI's Nanotech 2007 conference is co-located with CleanTech 2007 (Santa Clara, CA; May 20-24, 2007) and will showcase many leading-edge nanotech solutions for clean-tech. Visit www.nanotech2007.org and www.cleantech2007.org.

Nanotech and the Consumer Economy. While nanotech may help cure cancer or curb global warming, maybe you just want your laptop battery to last longer. Nanotech is there too.

The biggest names in electronics and semiconductors—Intel, AMD, HP, Agilent and Motorola—all have nano R&D programs, covering chips and components for PCs, laptops, cellphones and PDAs.

Other nano initiatives could bring brighter and cheaper flat-panel TVs, stronger tires, cheaper and more efficient gasoline, and self-repairing engines. Boeing and Caterpillar are even exploring nanotech to improve airplanes and earth movers.

Top Chemical Firms Safeguard Nano's Promise. Beyond the flashy research, getting nano-inventions to market also means ensuring nano does no harm.

BASF, DuPont, Dow, P&G, and a dozen more of the world's largest chemical companies are collaborating with U.S. and international

Nanotechnology Matters

Government, academic and corporate R&D open doors to better medicine, faster PCs and a cleaner environment.

Written by Vance McCarthy

Thousands of nanotechnology experts—researchers, engineers and product specialists—are quietly cracking long-unseen codes about how the universe works at the tiniest scale.

Over the past 3 years, the government's National Nanotechnology Initiative (NNI) and other programs have poured \$2 billion-plus into nanotech exploration. Now, we have thousands of new nano discoveries—building blocks for nano's future, some as small as one or two molecules.

In 2007, R&D spending is intensifying. The U.S. Departments of Energy (DOE) and Defense (DOD) will spend another \$3 billion-plus on pure nano-related projects by 2010. This should attract more commercial R&D money. At decade's end, it's predicted most Global 500 firms will make, buy, or have investments and/or partnerships in nanotechnology.

This section is designed to help *BusinessWeek* readers get their bearings on nanotech opportunities, and how nano could affect their lives, finances, careers and even their company's future. Let's get started.

Visualizing Up Nano. Nanotechnologists work at the molecular scale. To give you some perspective, a sugar granule is about 1-millimeter wide. Zoom down 1-million times smaller and you get a single sugar molecule, which measures 1.0 nanometer.

Nanotechnology encompasses materials, chemicals, devices, structures and processes at scales between 0.1 nanometers to

agencies under the mantle of The American Chemistry Council's Nanotechnology Panel, www.americanchemistry.com. Their goal: to ensure nanotechnology advancements move forward while protecting the environment, human health and safety (EH&S).

ACC's Nanotechnology Panel boasts 16 companies, and is encouraging governments to set priorities for conducting EH&S research. The Panel also works with scientists to discover, measure and evaluate potential risks that might arise from production, use and disposal of nanomaterials.

"Right now, many of our [members] are engaged in nanotech R&D. They know the value of having this kind of research in place early," said Bill Gullledge, Manager of the American Chemistry Council's Nanotechnology Panel and Managing Director of ACC's Chemical Products and Technology Division. "What would be a chilling effect on early stage [nanotechnology] R&D would be the uncertainty that may be associated with a whole new set of marketplace regulations for nanotechnologies," prior to a thorough review and the application of today's regulatory framework for nanomaterials and their related bulk chemicals.

Wanting to be included in any groundbreaking nano-initiatives, ACC's Nanotechnology Panel members are cooperating on projects to ensure strong EH&S practices for nano. Among ACC's aims is to work with others to: (1) identify multi-national EH&S research strategies; (2) identify "representative" nano-materials for further investigation, and (3) develop health and environmental test methods for assessing "representative" nano-materials.

Lessons from Current Practices. ACC's Nanotechnology Panel members continue to apply to their nano work current hazard identification and risk assessment principles, developed from their bulk chemical "product stewardship programs," Gullledge said. "Lacking specific measurement techniques in the nano-range, some companies are using experience gained in managing the bulk material." ACC members are eager, meanwhile, to participate in research that will develop specific nanoscale measurement techniques, he added.

Meanwhile, to capture the necessary strong approaches and good data, ACC's Nanotechnology Panel wants to leverage its vast experience to help (1) gather technical information; (2) evaluate the specific characteristics of nanomaterials in order to adequately characterize potential hazards, and (3) measure potential health and environmental impacts throughout the product life cycle and ultimate disposal. [To "characterize" is to test and analyze to identify and categorize attributes and properties of chemicals under various conditions.]

"Many [ACC] Panel members participated in generating hazard information for the High Production Volume chemical assessment programs [from the U.S. Environmental Protection Agency]. From this experience, they have a lot of knowledge in characterizing chemicals," Gullledge says. "But, our members would benefit from ongoing and future research on characterization of nanomaterials, and possible future information that agencies will be looking for."

So, ACC is asking EPA to make identification and characterization of nanomaterials a research priority. Gullledge is hopeful the go-



essential₂unl

ernment's FY2008 discretionary budget will fund these programs. ACC members are also encouraging EPA to implement a voluntary nanomaterials stewardship program. "We participated in an advisory capacity as EPA developed their early draft for the program, and we are very excited for it to get off the ground," Gullledge said.

While ACC members await a formal EPA program, they are working on EH&S nano programs with other groups.

With the Organization for Economic Co-operation and Development (OECD), ACC, working within an international industry coalition, is working towards establishing a comprehensive database of nanomaterials and related EH&S information. In a program Gullledge called "very aggressive," OECD is also identifying research strategies for working with nanomaterials, and sharing common national approaches for evaluating risk and conducting risk assessments.

With the National Institute of Occupational Safety and Health (NIOSH), ACC panel members are helping to conduct research to measure and control potential workplace exposure to nanomaterials. ACC is also watching ongoing implementation of a voluntary nanotechnology program recently launched in the U.K.

Asked whether ACC's work is simply an effort to preempt harsher nano regulations, Gullledge is candid. "There is nothing on the radar at this time that suggests Congress or federal agencies want new or special regulations for nanomaterials. I hope as an industry we will go through information collection and analysis efforts, such as these voluntary programs, before governments here or abroad, make any rash decisions

about the need for more regulations for the nanotechnology industry."

"That said," Gullledge adds, "our challenge is to continue to demonstrate the [chemical] industry's commitment to safety and the protection of human health and the environment. Applying product stewardship principles, such as ACC's Responsible Care Program, to nanomaterials could help ensure that EH&S issues do not become potential problems, and is the proper approach, I believe." ■



NSTI

Nano Science and Technology Institute

The Nanotech for Investors Summit (May 21, 2007 in Santa Clara, CA) offers executive-level advice and perspective from the world's leading investors, along with access to top nanotech business and technology execs. "The Summit will provide attendees a financially focused outlook on how nanotechnology is affecting global investments across various markets, and candid discussion on opportunities and risk," said Dr. Aymeric Sallin summit co-chair, and co-founder of NanoDimensions a pioneering nanotech VC firm. The summit is co-hosted with NSTI. (508) 357-2925 www.nsti.org/nanotech2007/nanoinvestor

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americanchemistry.com

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Nanotechnology Pioneers

QuantumSphere, Inc. (Santa Ana, CA) is a leader in bringing nanotechnology to battery and clean-energy applications. In 2007, this maker of high quality nano catalysts revealed two new nano-based fuel cell and hydrogen generation technologies, which will boost power and cut manufacturing costs.

Founded in 2002, the company has a growing IP portfolio of processes and applications. Alongside its in-house engineering staff, led by a former aerospace scientist, QuantumSphere works closely with U.S. national labs and leading universities on nano-scale catalyst materials. QuantumSphere has a unique ability to produce ultra-pure, highly uniform nano-metals and alloys in high volume.

"By enabling low-cost, portable power and efficient renewable energy production with high-performance nano catalysts, QuantumSphere is delivering on its promise to alleviate our nation's over dependency on conventional sources of energy today," said QuantumSphere's CEO and co-founder Kevin D. Maloney.

QuantumSphere aims to be a leading provider of high-performance catalyst materials and electrode devices for clean-energy applications, including batteries and micro fuel cells for portable power, and hydrogen generation through electrolysis. Analysts estimate today's global catalyst market at \$10+ billion a year. (714) 545-6266; www.qsinano.com

Advanced Diamond Technologies, Inc. (Romeoville, IL) makes diamond one carbon atom at a time. ADT's UNCD® (ultra-nanocrystalline diamond), born of U.S. Department of Energy research, has the smallest grains of any form of diamond. This makes UNCD purer, smoother, and more uniform than traditional diamond and suitable for electronics. Soon, ADT's diamond will power cellphones and biosensors. "We turn 50 cents worth of natural gas into \$500 of diamond by rearranging the carbon atoms," said ADT's president Neil Kane. UNCD won Frost and Sullivan's 2006 Product Innovation of the Year Award. (815) 293-0900; www.thindiamond.com

MEMSCAP Inc. (Durham, NC) solutions include components, component designs, manufacturing and related services. MEMSCAP's Custom Products Business Unit's US operations are located in RTP, NC, where one of the largest MEMS intellectual property portfolios, standard processes and a TL9000 quality system are leveraged to support customers from development to production. "We let our customers leverage MEMS and nanotechnologies to create new products, improve existing products, and accelerate design and manufacture," says MEMSCAP Custom Products Business Unit General Manager, Ron Wages. (919) 314-2200; www.memscap.com

Ambios Technology Inc. (Santa Cruz, CA) is a leading manufacturer of surface measurement, visualization, and characterization instruments in the industrial and academic nanotechnology marketplace. "Our recent acquisition of Quesant Instrument Corp. has allowed us to extend our initial market successes in high resolution contact and non-contact profilometry to the nano-scale with atomic-scale imaging systems," says Ambios President and CEO Patrick O'Hara. With a compounded annual revenue growth rate of 35% since the installation of their first instrument in 2001, Ambios is poised to be a significant contributor to the growing nanotech tools sector. (877) 429-4200; www.ambiotestech.com

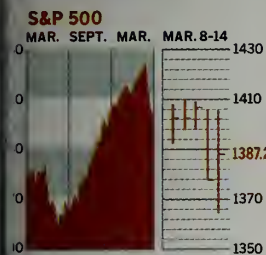
Pennsylvania NanoMaterials Commercialization Center (Pittsburgh, PA), a non-profit, promotes commercializing nanomaterials research for U.S. business and defense. The Center's industry partners include Alcoa, BayerMaterial Science, PPG Industries, Plextronics, U.S. Steel and Pittsburgh Technology Council. Partnering universities are Carnegie Mellon University, Pennsylvania State University, and University of Pittsburgh. Funding comes from the U.S. Department of Defense and the Commonwealth of Pennsylvania. The Center's focus includes low-cost solar cells, enhanced polymers, and improved heat exchangers. "We want to commercialize promising nanotechnology research within Pennsylvania's businesses and academia," says Center Executive Director Dr. Alan Brown. (412) 915-4205; www.pananocenter.org

mPhase Technologies (Norwalk, Conn.), trading OTC as XDSL, is working with the U.S. Army at Picatinny, Rutgers, The State University of New Jersey and leading research organizations on two blockbuster projects. "Our job is to drive MEMS and nanotechnology R&D into leading-edge products," says mPhase CEO Ron Durando. mPhase's two current projects are: a battery built with nanostructures to last longer, store more energy and be safer to discard; and a fan of magnetometers made from MEMS structures smaller than the date on a penny. It would detect magnetic fields disturbances, and could be used for security applications and to augment GPS and GPS-denied electronic devices, and even help guide smart munitions. (973) 256-3737; www.mphasetech.com

Nanotech Ventures and Cleantech 2007 Ventures (May 22-24 in Santa Clara, CA), will provide investors and corporate partnership and business development execs an ideal opportunity to meet and evaluate more than 100 early-stage public and pre-IPO companies in the nanotech and cleantech sectors. "The combined Nanotech/Cleantech Ventures event will bring together executives from these pioneering companies with industrial users, funders, technology providers and analysts," says Dr. Matthew Laudon, Executive Director of the National Science and Technology Institute, the events' producer. (508) 357-2925; www.nsti.org/nanotech2007 and www.cleantech2007.org



STOCKS



COMMENTARY

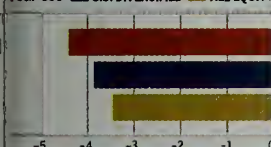
...this is what volatility feels like. While mortgage jitters sparked a selloff on Mar. 13, investment bank and major mortgage player Lehman others reassured the market with news that rising default rates wouldn't hurt its bottom line, helping to offset investor worries over the subprime woes at automaker General Motors.

Source: Bloomberg Financial Markets, Reuters

MUTUAL FUNDS

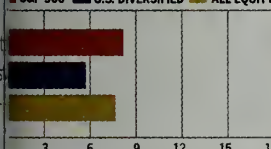
4-WEEK TOTAL RETURN

WEEK ENDED MAR. 13
■ S&P 500 ■ U.S. DIVERSIFIED ■ ALL EQUITY



2-WEEK TOTAL RETURN

WEEK ENDED MAR. 13
■ S&P 500 ■ U.S. DIVERSIFIED ■ ALL EQUITY



Source: Standard & Poor's

U.S. MARKETS

	MAR. 14	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
S&P 500	1387.2	-0.3	-2.2	6.9
Dow Jones Industrials	12,133.4	-0.5	-2.6	8.8
NASDAQ Composite	2,371.7	-0.1	-1.8	3.3
S&P MidCap 400	822.8	-0.1	2.3	5.9
S&P SmallCap 600	397.6	0.1	-0.6	4.7
DJ Wilshire 5000	13,992.1	-0.3	-1.6	7.2

SECTORS

			% CHANGE YEAR TO DATE	LAST 12 MONTHS
BusinessWeek 50*	783.1	-0.3	-1.9	2.2
BW Info Tech 100**	428.6	0.6	-4.2	10.0
S&P/Citigroup Growth	636.3	-0.4	-2.5	3.9
S&P/Citigroup Value	749.6	-0.3	-1.9	10.0
S&P Energy	439.0	-0.1	-3.6	10.6
S&P Financials	468.4	-1.5	-5.4	6.0
S&P REIT	203.3	1.4	2.2	18.3
S&P Transportation	261.1	-0.3	-1.0	-2.6
S&P Utilities	193.3	0.5	3.6	19.3
GST Internet	196.9	-0.4	-1.4	4.2
PSE Technology	873.8	0.5	-0.2	-0.1

*March 19, 1999=1000 **February 7, 2000=1000

GLOBAL MARKETS

	MAR. 14	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
S&P Euro Plus (U.S. Dollar)	1931.5	-1.9	-2.9	16.8
London (FT-SE 100)	6000.7	-2.5	-3.5	0.8
Paris (CAC 40)	5296.2	-2.9	-4.4	3.5
Frankfurt (DAX)	6447.7	-2.6	-2.3	9.8
Tokyo (NIKKEI 225)	16,676.9	-0.5	-3.2	2.7
Hong Kong (Hang Seng)	18,836.9	-0.4	-5.6	21.4
Toronto (S&P/TSX Composite)	12,808.7	-1.4	-0.8	7.0
Mexico City (IPC)	26,719.3	2.0	1.0	41.1

FUNDAMENTALS

	MAR. 13	WEEK AGO	YEAR AGO
S&P 500 Dividend Yield	1.86%	1.83%	1.78%
S&P 500 P/E Ratio (Trailing 12 mos.)	16.7	16.9	18.1
S&P 500 P/E Ratio (Next 12 mos.)*	14.7	14.9	15.1
First Call Earnings Revision*	-0.41%	0.90%	-0.67%

*First Call Corp.

TECHNICAL INDICATORS

	MAR. 13	WEEK AGO	YEAR AGO
S&P 500 200-day average	1348.9	1346.2	Positive
Stocks above 200-day average	63.0%	67.0%	Neutral
Options: Put/call ratio	1.14	1.32	Positive
Insiders: Vickers NYSE Sell/buy ratio	6.72	7.36	Negative

BEST-PERFORMING GROUPS

	LAST MONTH %		LAST 12 MONTHS %
Tires & Rubber	12.4	Tires & Rubber	109.1
Oil & Gas Refining	9.5	Divsfd. Metals & Mining	50.5
Power & Energy Traders	4.7	Steel	47.5
Constr. Materials	3.2	Constr. Materials	45.3
Wireless Services	3.1	Power & Energy Traders	34.6

WORST-PERFORMING GROUPS

	LAST MONTH %		LAST 12 MONTHS %
Homebuilding	-16.6	Homebuilding	-29.7
Spclzd. Cnsmr. Serv.	-15.6	Distillers & Vintners	-23.8
Automobiles	-14.8	Photographic Products	-20.8
Distillers & Vintners	-11.5	Electric Mfg. Svcs.	-18.9
Motorcycles	-11.5	Gold Mining	-16.6

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS			
Japan	-0.7	Pacific/Asia ex-Japan	27.0
Utilities	-1.5	Utilities	22.3
International Hybrid	-1.9	Real Estate	22.1
Domestic Hybrid	-2.0	Latin America	20.9
LAGGARDS			
Latin America	-8.0	Japan	-2.3
Real Estate	-6.6	Health	-2.1
Financial	-6.3	Technology	0.6
Precious Metals	-6.0	Small-cap Growth	1.5

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS			
DireXn. Sm. Cap Bear 2.5X	13.6	Dreyfus Prem. Grtr. China A	56.7
DireXn. S&P 500 Bear 2.5X	11.6	Old Mut. Clay Finlay Ch. A	49.9
Rydex Dyn. Russell 2000 H	11.3	Oberweis China Opprt.	49.3
ProFds. USh. Small Cap Inv.	11.2	E.I.I. Int. Property Instl	47.9
LAGGARDS			
ProFunds Precs. Mtls. Inv.	-15.6	DireXn. Emrg. Mkts. Short	-32.3
DireXn. Lat. Am. Bull 2X Inv.	-14.4	American Heritage Grth.	-25.0
DireXn. Sm. Cap Bull 2.5X	-13.6	DireXn. Dev. Mkts. Bear 2X	-22.6
ProFunds. Real Est. Inv.	-13.3	Prasad Growth	-19.5

INTEREST RATES

KEY RATES

	MAR. 14	WEEK AGO	YEAR AGO
Money Market Funds	4.86%	4.86%	4.08%
90-Day Treasury Bills	5.05	5.09	4.59
2-Year Treasury Notes	4.55	4.53	4.64
10-Year Treasury Notes	4.53	4.49	4.69
30-Year Treasury Bonds	4.70	4.63	4.71
30-Year Fixed Mortgage †	6.01	6.05	6.30

† BankQuote Inc.

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND	30-YR. BOND
General Obligations	3.73%	4.08%
Taxable Equivalent	5.33	5.83
Insured Revenue Bonds	3.85	4.34
Taxable Equivalent	5.50	6.20

THE WEEK AHEAD

RESIDENTIAL CONSTRUCTION

Wednesday, Mar. 20, 8:30 a.m. EDT Housing starts are forecast to have picked up a little to an annual rate of 1.46 million in February, from 1.41 million in January. That's the median forecast of economists surveyed by Action Economics.

FEDERAL RESERVE MEETING

Tuesday, Mar. 19, 9 a.m. EDT The Federal Open Market Committee begins a two-day monetary policy meeting.

Economists queried by Action Economics are unanimous in their expectation for the Fed to keep interest rates at 5.25%.

LEADING INDICATORS Thursday, Mar. 22, 10 a.m. EDT The Conference Board's index of leading economic indicators for February probably held steady, after inching up 0.1% in January. Drags from higher initial jobless claims and weaker consumer expectations should be offset

by higher average stock prices during February as compared to January.

EXISTING HOME SALES Friday, Mar. 23, 10 a.m. EDT Existing home sales in February most likely cooled a little more to an annual rate of 6.32 million units. Sales in January unexpectedly bounced up to an annual rate of 6.46 million. Harsher winter weather likely crimped housing activity in February.

The BusinessWeek production index declined to 292.8 for the week ended Mar. 3, but stood 8.5% above the year ago level. Before calculation of the four-week moving average, the index fell to 290.9.

BusinessWeek .com

For the BW50, more investment data, and the components of the production index visit www.businessweek.com/extras.

**It's about money.
Earning it.
Investing it.
Spending it.**



Check out this weekend's show March 17 and 18:

Real Estate Relief: Whether you're moving in or out, we've got advice for getting the best deal in a shaky housing market.

BusinessWeek 50 Rankings: Our annual list of the best-performing companies, with strategy insight from CEO Lew Frankfort of #2-ranked Coach.

Luxe Airport Cuisine: See how meals at busy terminals have taken off to include upscale delights from steaks to sushi.

Tax Tips: Learn about new and little-known tax credits that can help you save this year.

BusinessWeek weekend

Airs Saturday/Sunday nationwide.
Find your local station and airtime by
zip code at businessweekweekend.com

Company Index

This index gives the starting page for a story or feature with a significant reference to a company. Most subsidiaries are indexed under their own names. Companies listed only in tables are not included.

A, B

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Accredited Home Lenders (LEND) 34
Adobe (ADBE) 78
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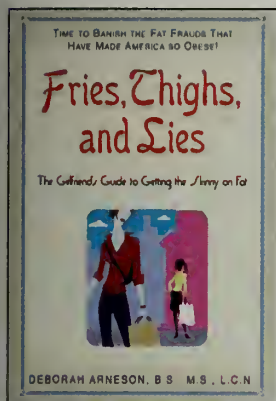
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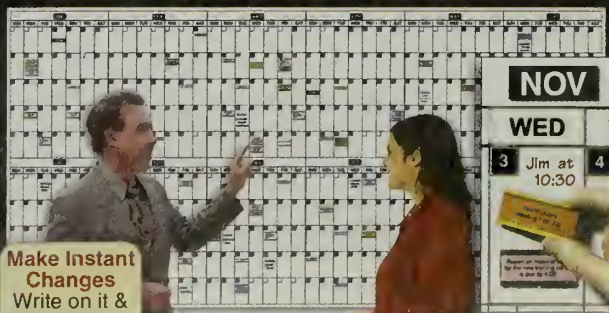
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The Doctor Is In a Rut

HOW DOCTORS THINK

By Jerome Groopman, M.D.; Houghton Mifflin; 307pp; \$26

Over a period of 15 years a young woman named Anne Dodge saw doctor after doctor in a quest to overcome what was consistently diagnosed as an eating disorder. Following meals she experienced nausea and intense stomach pain, and sometimes she vomited. Nothing seemed to help—not therapy,

not antidepressants, and certainly not the 3,000-calorie-a-day diet her internist prescribed. Her weight dropped to 82 pounds, and she was in danger of starving to death.

Dodge consulted as many as 30 doctors before she finally found one willing to consider that her problem might be something different from what others had diagnosed. He ran a battery of tests and spent hours talking with Dodge. Finally he hit on the solution: She had a rare autoimmune disease that she could control easily by eliminating gluten from her diet. Almost instantly, Dodge got her life back.

Health-care horror stories such as Dodge's are the backbone of *How Doctors Think*, by Dr. Jerome Groopman, a practicing physician and a professor at Harvard Medical School. Drawing partly on his own experience, Groopman delves deeply into the cognitive processes and prejudices that can drive physicians toward faulty diagnoses. Add in industry pressures, he argues, such as profit-hungry HMOs and aggressive pharmaceutical marketing practices, and you end up with a recipe for bad medical care. In a tone that grips but is never overwrought, Groopman provides a rare window into the doctor's exam room and passes along lessons valuable to all patients.

In chapter after chapter, Groopman methodically lays out the most common pitfalls for doctors, illustrating each with compelling real-life case studies. For example, there are "representativeness errors," which occur when a doctor's diagnosis is swayed by prototypes. An emergency-room physician misdiagnoses a fortysomething forest ranger's chest pain as a strained muscle because the patient looks too healthy to have heart problems. In fact, he has unstable angina and shows up in the ER the next day with a full-blown heart attack. Then there's "diagnosis momentum," the tendency for each health-care provider brought into a case to accept blindly the initial doctor's diagnosis. "Diagnosis momentum, like a boulder rolling down a mountain, gains enough force to crush anything in its way," Groopman writes. That's what happened to Dodge.

Groopman also makes a strong case against the health-care industry, which he believes is adding to the pressure on doctors to take cognitive shortcuts. As managed-care companies cut reimbursement rates, providers respond by cramming as many patients as they can into a day. Groopman writes of one Boston practice that instructed its physicians to cut each new-patient appointment from an hour to 40 minutes and to limit follow-ups to no more than 15 minutes. Also, they were told to fill out electronic templates as they talked to each patient in the hope that the tablet computers would help speed up the billing process.

Meanwhile, the pharmaceutical industry bombards consumers with ads imploring them to "ask their doctors" about new drugs. Many physicians so fear losing business that they would rather give in to patients' drug demands than figure out if the requested medicine is the solution, Groopman says.

While Groopman sprinkles in examples of his own mistakes and those made by doctors who have treated him, the cases beyond his own practice provide the book's most eye-opening moments. He introduces readers to Rachel Stein, a rabbi who adopted a baby from Vietnam. When the child, named Shira, became desperately ill just days after arriving in the U.S., hospital physicians diagnosed her with severe combined immunodeficiency disorder (SCID), an inherited disease

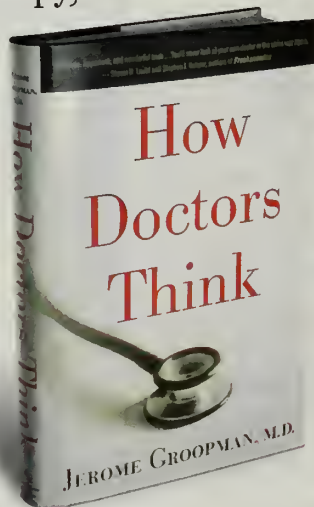
common in Asia. The only hope they said, was a bone marrow transplant, a treatment so harrowing it would put Shira's life at risk.

Stein spent hours researching SCID and corresponding with families affected by it. She became convinced that the problem was malnourishment, not SCID, and demanded the hospital run a battery of tests. Stein was right: Shira's immune system was normal, and proper feeding put her on the road to

recovery. Because the baby fit the stereotype of the typical SCID patient, doctors overlooked the simpler diagnosis.

The most practical part of Groopman's book is the epilogue. There he encourages patients to challenge their doctors and even suggests the exact language to use. He recommends broad, open-ended questions such as "What else could it be?" or "Is there anything that doesn't fit?" After reading these tales of misdiagnoses and life-threatening decisions, patients will likely decide to take his advice.

—By Arlene Weintraub



Why botched diagnoses happen—and how patients can help avoid them

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Inside the Mortgage Crisis

ANGELO MOZILO wants to make one thing perfectly clear: Countrywide Financial, whose stock is down more than 20% for the year, should not be lumped in with the subprime outfits that are getting hammered. In a wide-ranging interview on Mar. 12, the CEO of America's No. 1 lender suggested that panic was gripping the market over mounting distress in the subprime business. But he also predicted that the bad news is far from over.

How exposed is Countrywide to the subprime mess?

In 2006 subprime loans were about 9% of our total business, now down to 7%. We're a prime lender...but we also have been on a mission...to try to increase home ownership opportunities for minorities and low-income borrowers. So it's distressful to me personally to see the piling on that's taking place by the media and regulators. This was a system that was working very well, providing an opportunity for people to get over that barrier of entry to owning a home. Now what you've had is panic setting in, and [the subprime story] is leading every newspaper. It's like there's no war going on in Iraq.

What will the impact be?

When you cut that first-time home buyer out, there's a ripple effect. I'll be the first to admit that a lot of players came into the industry that were not banks, not even mortgage banks, and that they exploited a certain number of people. But that exploitation was in the minority. You had 17 increases in the Fed funds rate. Then those [exotic] loans began to reset, and that was the tipping point. When you begin to cut off the demand, values start to recede. And there's an old saying that you never know who's swimming naked until the tide goes out.

So the industry got a little crazy with some of the lending?

It's no different than the equity markets and tech booms. Any kind of bubble like that creates irresponsible behavior. And we did have a bubble in real estate.

Do you worry that the subprime fallout will bleed into the prime mortgage market?

I don't think it's going to bleed substantially into prime.

You've said that you've never seen a soft landing in housing. Never seen it. That's right.

Is the worst over?

It's always hard to tell when you're at the bottom...but I think that there's more to come out in terms of delinquencies and foreclosures. I just came from giving a speech in Las Vegas where there are 22,000 homes for sale. That's a lot of inventory to eat through.



MOZILLO has never seen a soft landing in housing

Will the Fed cut rates if the subprime mess spreads?

In terms of the economy, so far I've been wrong. I thought that the housing downturn would have an impact on the economy. That hasn't happened, but maybe enough time hasn't gone by. Historically, housing has led the country in and out of recessions. But there's an argument that the economy is big today that housing is not as important as it was. I don't believe

Let's talk more about the ripple effect and your business.

It reminds me of when the S&Ls were beating us up for a while and then they all went away. Now you have these subprime guys going out of business rapidly, and that's all positive for Countrywide. I said three quarters ago that Ameriquest and New Century were distorting the business and taking away rational pricing. That's why you saw our volume of subprime go down. We just pulled back.

The Wall Street Journal said you sold \$140 million worth of stock. Do you worry that shareholders will say: "Oh well, he's selling. He must be losing confidence. Maybe I should sell?"

As a CEO, the only way to eliminate that issue is to never sell stock, just die. Die owning the stock and never exercise an option. In fact, I've sold very little stock. Almost all of what I owned were options I accumulated over the last 10 years. I've chosen to keep most of my net worth in Countrywide.

Maria Bartiromo is the anchor of CNBC's Closing Bell.



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Ideas **The Welch Way**

BY JACK AND SUZY WELCH

The Right Way to Say Goodbye

You recently wrote a column about hiring the right way. Can you follow up with the same detail on firing? I think I was fired in the wrong way.

—Anonymous, Balch Springs, Tex.

We wouldn't be surprised, since that happens far more often than not. In fact, letting people go in a way that doesn't engender a lot of bitterness is rare in business. It requires an entirely unnatural act for managers: seeing the person being fired through the whole agonizing process. Half of firing right is not running away after you say goodbye. The other half is never letting the firing be a surprise in the first place.

Now we're not talking about firing for integrity violations. When that happens, make sure everyone knows why you're kicking the person out—a teaching moment—and get on with business. No, we're talking about letting someone go for underperformance, a much more fraught event for one major reason. In such cases, the person doing the job and the person getting the job done to him are almost always on clashing emotional life cycles.

Take the case of Bob, a typical overworked manager who wants minimal angst in his organization, and Richard, a nice subordinate who has been vaguely underperforming for a few years. Eventually, Richard makes enough mistakes that Bob wants him to go. The decision gnaws at Bob, though, and for weeks he wrestles with his emotions. He agonizes to his wife, "Richard is going to freak out. He's so clueless—and his daughter just started college." Meanwhile, Richard continues to plod away. He may sense Bob's awkwardness but assumes it's nothing personal. After all, he reassures himself, his last performance review had no red flags; it gave him a 3% raise and some O.K. comments.

Finally, Richard really blows a project, and Bob has had it. He calls him in and lets loose. "People have been carrying your load for too long, and no one can take it anymore," he says. "You have to go. I'm sorry." Richard sits there like he's been sucker-punched. Bob mistakes the silence as acceptance and hastily ends the meeting. Big mistake. Within 24 hours, Richard starts feeling anger and hostility. No one ever told him he was screwing up! His firing, he convinces himself, is an outrage. While Richard is getting madder by the minute,

Bob is feeling better. "I finally did it," he tells his wife. "What a relief! I can't wait to find someone new." He asks HR to put together a decent severance package for Richard, gives him two weeks to "settle things up," and then works very hard to bump into him in the hallway.

IS IT A SURPRISE, THEN, when Richard files a lawsuit against the company or becomes a whistle-blower about a perceived wrongdoing? Is it any wonder that when Richard is finally hired by a customer, that company suddenly doesn't want to do business with Bob anymore?

Of course not. And yet, this scenario—the firing life cycle happens again and again in business. As different emotions play out, managers feel relief while "victims" feel everything but, creating a personal and organizational car wreck.

Which brings us back to what managers must do. Let's start with preventing the surprise goodbye, which can be accomplished with rigorous and candid performance evaluations, twice a year at the minimum. All employees must always know where they stand, especially if it is close to the exit. Yes, it can be difficult to deliver the news that someone is screwing up. And yet those are the reviews you just cannot avoid. Force yourself to schedule them. And on you're sitting across the table from your own Richard, resist the temptation to sugarcoat hard messages. You're helping one, least of all the employee who's being lulled into a false sense of security.

With the surprise taken out of goodbye, the only other part about firing right is preserving the dignity of the person being dismissed. Start by giving the departing employee months—not weeks—to find a place where his or her skills are a better match, and in that period fight any appearance of abandonment. Yes, you may feel as if you've already spent enough time on the underperforming employee; in fact, you need to spend a bit more. Bob thought his job was done when he fired Richard. It had just begun. Indeed, a good firing means you become a coach and adviser. You tell the employee for periodic lunches and check in with him more often than that. You suggest new career directions and possible companies to join. In every way, you help make the exit as devoid of humiliation as possible.

Look, firing is the worst part of business for everyone involved. It sounds like it was painful for you—and not necessarily painful enough for your manager. ■■

Jack and Suzy Welch look forward to answering your questions about business, company, or career challenges. Please e-mail them at thewelchway@businessweek.com. For their weekly podcast go to www.businessweek.com/search/podcasting.htm.

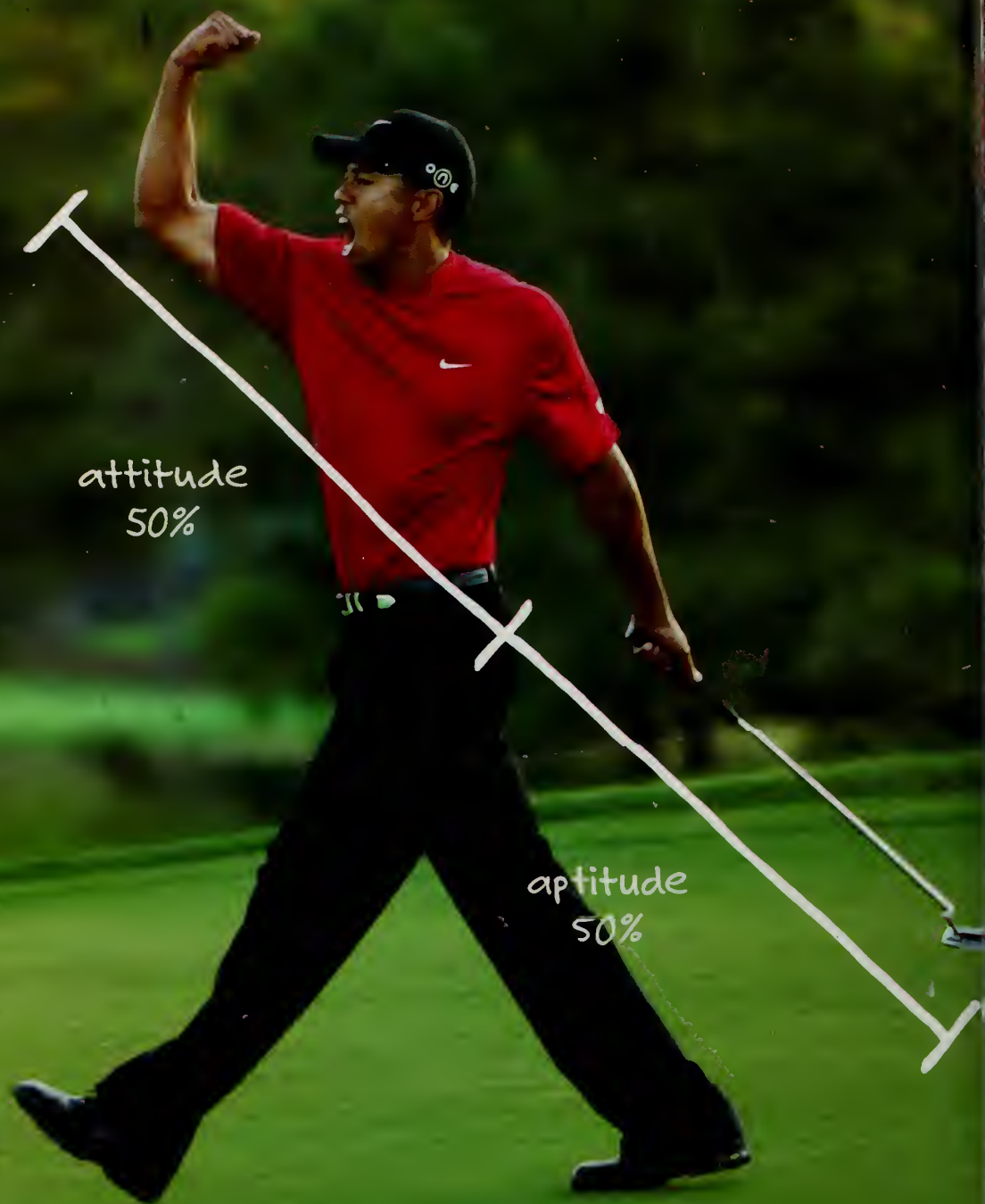
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BusinessWeek (ISSN 0007-7135) Issue number 4028, published weekly, except for one week in January, July and August, by The McGraw-Hill Companies, Inc. Executive, Editorial, Circulation, and Advertising Offices: 1221 Avenue of the Americas, New York, N.Y. 10020. Periodicals postage paid at New York, N.Y. and at additional mailing offices. Canada Post Publication Mail Agreement Number 2501. Return undeliverable Canadian addresses to: DPGM Ltd., 6 Bath Road, Mississauga, ON L4T 1L2. Email: bwkcustserv@mcgraw-hill.com
Master: Send address changes to BusinessWeek, P.O. Box 8418, Oak, IA 51591-1418



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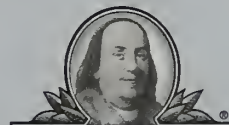
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When it came to our tasting of "white goods," the superpremiums ruled the day. Here, our top three in each category, plus our tasters' comments:

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Green is going (clockwise from left) to BofA's New York tower; compact fluorescent bulbs; corn for ethanol.



The Eco-Conscious Business

Carbon footprints. Climate change. Sustainability. They're just a few of the eco-buzzwords that have entered the business lexicon. In a *BusinessWeek.com* **Special Report on Green Business**, we go beyond catchy phrases to look at the issues companies face as they embrace the green movement. Take the growing ethanol backlash. As demand for the fuel drives up corn prices, an unlikely assortment of groups is uniting with the hope of cutting government support. Meanwhile, a major eco-construction project is under way in New York. Bank of America's \$1.3 billion, 55-story tower will be **the second-tallest building in New York** and a model of environmental responsibility. For eco-conscious entrepreneurs, the latest take on business plan competitions aims to turn ideas for reducing the use of fossil fuels into working businesses. See our slide show for profiles of some winners. Finally, it has become easier than ever to live "green"—witness our slide show on 12 products for a greener home. Go to www.businessweek.com/go/07/green for all this and more.

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"The longer it lasts, the worse it will be when it ends."

—Carlyle Group co-founder William Conway in an internal memo warning colleagues that an era of cheap debt has caused private equity firms—including his own—to make "risky credit decisions" that could come back to haunt them when the market shifts.

EDITED BY DEBORAH STĒAD

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STOCK PERFORMANCE

The CEO Mega-Mansion Factor

NOW THERE MAY be one more thing to consider before investing in a stock: Does the CEO own a trophy house? Finance professors David Yermack of New York University and J. Michael Liu of Arizona State University looked at the relationship between stock performance and the size of a CEO's home. The bigger and pricier the house, they found, the greater the risk of stock price declines. "If [the CEO] buys a big mansion, sell the stock," Yermack says. "Many of these guys have been top performers, but at some point that changes, and they reap the benefits."

Armed with the addresses of 432 CEOs of S&P 500 companies at the end of 2004, Yermack and Liu found that 15% of them lived in homes of at least 10,000 square feet, or on a minimum of 10 acres. And their companies' stocks?

In 2005 they lagged behind those of S&P 500 CEOs living in smaller houses by 25%, on average. Energy infrastructure supplier **Power-One**, whose then-CEO

Steven Goldman bought a 12,000-sq.-ft. beachfront property in Malibu, Calif., in 2000, was the worst performer, with shares down more than 30%. And Robert Nardelli, who bought a 19,000-sq.-ft. Atlanta mansion and spent lavishly to expand it after taking over as CEO of **Home Depot** in 2001, saw his company's stock drop 5% in 2005. The S&P 500 index rose 3% that year. A **Power-One** spokesperson declined comment. Nardelli did not respond to a request for comment.

Yermack and Liu also looked at 164 CEOs in the sample who bought houses after taking the corner office, and found 23 had gone for big homes. There was the 13,000-sq.-ft. L.A. house bought by **Hilton Hotels'** Stephen Bollenbach in 1997 and the 24-acre estate in Bedford, N.Y., purchased by Howard Solomon of **Forest**

Laboratories in 2002. In the 36 months after their purchases, Hilton trailed the S&P by 74% and Forest Labs by almost 25%. Hilton declined to comment, as did Forest. And together, all 23 companies lagged the S&P by roughly 25% in the three years after their CEOs' purchases, while smaller-home buyers' companies beat it by 22%.

—Jane Sasseen



SWEET HOMES The residences of **Power-One's** Goldman (above) and Nardelli, late of **Home Depot**



CAMPAIGN WATCH



AUTO POLITICS

DRIVING THE CANDIDATES

LOOKING FOR A SIGN that Al Gore may be a Presidential candidate after all? Here's one: He recently bought two **Mercury Mariner** gas-electric hybrid SUVs. Gore had been publicly warned by UAW President Ron Gettelfinger that his three **Toyotas** (two Priuses and a Lexus, all hybrids) would be a problem with the union if he mounted a White House run.

Yes, everything counts in the age of gotcha politics. And that includes the family ride and a campaign's vehicles.

Bill Clinton, who figures to be stumping with Hillary, had Ford customize a Mercury Mariner hybrid for his Secret Service detail—extra leg room in the rear, a fridge, mood-lighting, and a map table. Senator Clinton, who rides in Secret Service vehicles, also uses the car.

Former Senator John Edwards just bought a 2007 **Ford Escape** gas-electric hybrid, and he has a **Chrysler Pacifica** and **GMC Sierra** at his North Carolina home. A spokesperson says Edwards and staff make sure all campaign rentals are American and "union made." (The Pacifica is actually made in Canada and Chrysler is German-owned.)

Governor Mitt Romney announced his candidacy at the Henry Ford Museum in Dearborn, Mich., where he pointed out the **AMC Rambler** that belonged to his father, a former American Motors Corp. chairman and the state's governor from 1963 to 1969. Romney will have a tough time connecting a green policy with his **Ford Mustang GT**, **Cadillac SRX**, and **Chevy Silverado**. But at least the UAW approves.

Senator John McCain owns a **Cadillac CTS**, which isn't especially fuel efficient, but it's American and built in Michigan, a blue state considered in play for McCain and Romney in 2008. His campaign makes stops in The Straight-Talk Express bus, which runs on diesel.

And Senator Barack Obama drives a Canadian-built **Chrysler 300C** sedan, which gets 20 mpg, hardly a green choice. His campaign has a flex-fuel **GMC Yukon**. It's U.S. and UAW-built, but gets 17 mpg on gas and even less using E85. Environmentalists may scowl, but it won't hurt in Iowa to have a car that uses ethanol. —David Kiley



Barack Obama

2005 GMC YUKON XL
Flex-fuel, can run on E85



Mitt Romney

2007 FORD MUSTANG GT
Fuel-thirsty convertible



John Edwards

2007 FORD ESCAPE
Gas-electric hybrid



CYBER-STRATEGY

HOW TO READ THE GOOGLE TEA LEAVES

A GOOGLE SEARCH can reveal a lot about whom President candidates consider to be their most serious rivals. The key: the list of paid-for links on the right-hand side of each hopeful's search-term results page.

Governor Mitt Romney's campaign paid enough to be the second-highest sponsored link on former New York City Mayor Rudy Giuliani's search results page in the week of Mar. 11.

Did Rudy return the compliment? No. Joinrudy2008.com, Giuliani's exploratory committee site, bid only enough to be the eighth link on the "Mitt Romney" results page.

And while the search term "Hillary Clinton" brought up Senator Barack Obama's campaign Web site as the second sponsored ad link, a Clinton campaign adviser says the New York Senator isn't likely to buy "Barack Obama" because it would indicate "that she was chasing or worried about Obama."

Meanwhile, that week no candidates bought links for the search terms "Joe Biden," "Bill Richardson," "Al Gore," "Sam Brownback," "Mike Huckabee," "Fred Thompson," or "Dennis Kucinich." —David Kiley

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IRONY WATCH



A SURPRISE IN THE SOROS PORTFOLIO

Conservative commentators are having a field day over a Feb. 14 securities filing by Soros Fund Management, run by billionaire philanthropist and antiwar activist George Soros, who financed a \$25 million media campaign to unseat President George W. Bush in 2004. The filing reports that in late 2006 the fund bought 2 million shares of Halliburton, whose KBR unit is the military's biggest Iraq war contractor. Soros Fund now has a 0.2% stake in Vice-President Dick Cheney's former employer. Halliburton is in the midst of spinning off KBR to focus on core oil services, but that didn't stop critics from denouncing what one called "the hypocrisy of the liberal elite." Soros spokesman Michael Vachon declined to comment, citing company policy. But Rush Limbaugh had plenty to say: "Halliburton has become a buzzword for corruption and lying and deceit as far as the left is concerned, and here's their guru now buying 2 million shares of Halliburton," he blogged. "It just doesn't get any better than this."

—Dawn Kopecki

STREET NEWS

GOODBYE, QUARTERLY TARGETS?

FOR ABOUT a decade, companies have tried to goose their stocks—or manage the market's expectations—by putting out quarterly earnings projections. Now the practice has come under fire as business leaders fret that the focus on short-term targets undermines long-term growth.

On Mar. 14 the Commission on the Regulation of U.S. Capital Markets in the 21st Century, a project of the **U.S. Chamber of Commerce**, urged executives to stop issuing their short-term goals. The practice is a "self-inflicted wound by American CEOs," says



commission member Robert Pozen, chairman of MFS Investment Management, a Boston fund manager.

Debate over this issue has simmered for years. Indeed, dozens of companies, including **Coca-Cola** and **McDonald's**, have quit publicizing quarterly earnings targets. Now the issue has become urgent, the Chamber argues, as U.S. companies face growing long-term competition from overseas, where such projections are

not widely made. In coming months, the Chamber hopes to create a groundswell by persuading more high-profile companies to drop these short-term estimates. But abandoning such projection comes with a caveat. "It's a great idea in theory, but the could be enormous volatility," says Glenn Curtis, director of strategic research at Thomas Financial. "When there's surprise, panic is not that far behind."

—Lorraine Woel

CANDID CAMERAS SNAPPING UP SNAPSHOTS

RATHER THAN trying to outshoot the hordes of amateur photographers who take cell-phone snaps of fires, celebrities, and plane crashes, **Getty Images** is enlisting them. On Mar. 12 the \$807 million Seattle stock-photo agency bought **Scoop**, one of the best-known new-style photo agents that have popped up to act as brokers between the media and so-called citizen photographers.

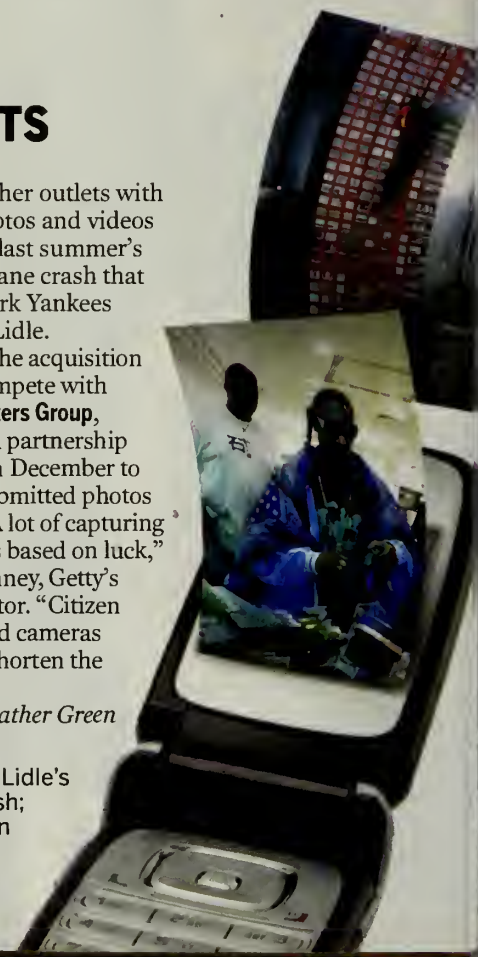
Former Scottish journalist Kyle MacRae founded Scoop in July, 2005, after watching the outpouring on CNN and BBC of amateur video clips of the Indian Ocean tsunami in 2004. Since then, Glasgow-based Scoop, which gives 40% of a picture or video's sale price to the photographer, has provided

British and other outlets with bystander photos and videos of events like last summer's Manhattan plane crash that killed New York Yankees pitcher Cory Lidle.

Getty says the acquisition will help it compete with rivals like **Reuters Group**, which set up a partnership with Yahoo! in December to solicit user-submitted photos and videos. "A lot of capturing the moment is based on luck," says Hugh Pinney, Getty's editorial director. "Citizen journalism and cameras with phones shorten the odds."

—Heather Green

ON THE SCENE Lidle's New York crash; Snoop Dogg in London





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THE MORTGAGE MESS

Beware the 'Silent Second'

THE LATEST time bomb ticking in the home lending industry: the "silent second," a second mortgage or line of credit taken out for fast cash by a new homeowner—usually without the knowledge of the first mortgage grantor.

On top of a declining housing market and a spike in defaults among homeowners, silent seconds pose an acute problem for original lenders,

Original lenders may not know of homeowners' additional mortgages

says Max Doubek, director of analytics marketing at **First American LoanPerformance**, a Santa Ana (Calif.) data and risk firm for the mortgage industry. This is

especially true for banks in the subprime market, he says, where borrowers have checkered credit histories.

Just how bad is the problem? One troubled top subprime lender, Doubek told *BusinessWeek*, recently asked LoanPerformance to conduct a stress

test on a sampling of loans the bank had originated as recently as last year's fourth quarter. LoanPerformance found that within months of getting their original mortgages, some 50,000 of 169,000 borrowers they screened had already gone to either the same lender or another bank to tap into the dwindling equity that remained in their houses—without the lender's knowledge.

THE RESULT, Doubek says, is that the properties of these borrowers have an average loan-to-value ratio of 95%, with some of the loans at more than 100% of the value of the house. Big financial institutions are in the dark about borrowers who have come back to them for another loan, he notes, because home equity lines of credit and first mortgages are often granted by separate departments that don't communicate with each other. "They might as well be different companies," he says.

Silent seconds are also bad news

for investors in mortgage-backed securities. A 2006 study by **Standard & Poor's**, which, like *BusinessWeek*, is owned by The McGraw-Hill Companies, analyzed the performance of nearly 640,000 mortgages with second liens in mortgage-securities portfolios and found that they are 43% more likely to go into default than first mortgage of comparable size where borrowers didn't go back to the bank. For subprime borrowers, that default rate rises to 50%. For mortgage-securities investors, says Joseph Mason of Drexel University's LeBow College of Business, "it's a game of hot potato in the dark."

—Mara Der Hovanes

QUESTION OF THE WEEK

TV's upfront season—the time of year when networks make their annual pitches to big advertisers—is almost upon us. What trends do you see?

"The upfronts are not going to go away. But marketers are not putting as much money towards them simply because there are more options. Why restrict your flexibility?"

Joe Tripodi, chief marketing officer, Allstate

"A hotly debated issue will be Nielsen ratings for commercials. We and the networks have yet to determine how to value that data. We're actively working on that."

Chris Boothe, president, media buyer Starcom USA

"This upfront will become an 'infront' because the complexity surrounding the proposed Nielsen commercial ratings, among other things, will drag out negotiations."

John Miles, director of investment, media communications agency MediaCom



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Equity Income Fund	19.14%	9.35%	10.13%	0.71%
Lipper Equity Income Funds Average	18.45%	8.61%	8.80%	1.47%
Global Stock Fund***	22.50%	12.13%	9.44%	1.22%
Lipper Global Large-Cap Growth Funds Average	16.79%	7.34%	6.49%	1.99%
Growth Stock Fund	14.05%	6.25%	9.20%	0.72%
Lipper Large-Cap Growth Funds Average	5.60%	2.15%	5.53%	1.65%
Value Fund	19.75%	9.75%	10.94%	0.90%
Lipper Multi-Cap Core Funds Average	13.33%	6.64%	8.71%	1.50%

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“Holy Cross was a place where no one ever cut you any slack academically.”

—Chris Foley
Marblehead, Mass.



A VISIONARY AT HOLY CROSS

“THE HOLY CROSS fraternity” (People, Mar. 12) is about a great and liberal Jesuit education foundation, an exceptional teacher and mentor who found his calling, and students who were able to become great. It is a testimonial to a particular education system that works. I’m a product myself of this Jesuit education system and found my own mentors. I believe they teach each of us to have an internal scale that allows one to handle whatever problems, differences, and situations come about.

—Marco Diaz
London

FATHER BROOKS WAS a visionary who transformed Holy Cross from a small Catholic Irish college into an institution of real higher learning. His vision brought coeducation, an end to very costly athletic scholarships [in favor of] the return of the student athlete, a self-sustaining endowment, and a legacy that’s being continued by Father [Michael P.] McFarland today. Having played with “Eddie J” and knowing Ted Wells as well as Stan Grayson,

Father Brooks’ vision has shown to be the correct one.

—Stephen Hicks
Warwick, R

I REMEMBER CLARENCE Thomas Holy Cross. He always wore a blue Holy Cross baseball warm-up jacket. Ever where. He seemed quiet, brooding. I understand his anger about being portrayed by the press as benefiting from affirmative action. He made it through a very tough English department and graduated cum laude. Holy Cross was a place where no one ever cut you any slack academically. His accomplishment was his own.

—Chris Foley
Marblehead, Mass.

THE CARBON FOOTPRINT OF VAIL RESORTS

I WOULD LIKE to register Vail Resorts Inc.’s disappointment with your recent article on carbon offsets, “Another inconvenient truth” (The Environment, Mar. 26).

Your article may leave readers with the impression that our commitment to the climate is nothing but hype. Nothing could be further from the truth. Vail Resorts is committed to reducing our energy

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The McGraw-Hill Companies

BusinessWeek

APRIL 2, 2007 (ISSN 0007-7135)

4028

Published weekly, except for one week in January, July and August by The McGraw-Hill Companies, Inc. **FOUNDER:** James H. McGraw (1860-1948).
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use and looking for sources of alternative energy. While it's true that we considered building a wind turbine on Vail Mountain, we quickly determined that trying to power our entire company through our own wind turbines was neither feasible nor environmentally responsible. Our local utilities were not an option because they simply did not have enough alternative energy for our needs. Renewable energy credits allowed us to fulfill our commitment to tap alternative energy sources and provide the investment necessary to encourage new wind power development in places where it made sense.

Since the climate is a truly global problem, it should not matter where the green electricity is generated, only that it replaces fossil fuel generation. Of course, there should be no secrecy in the process and contrary to your article's insinuation, Vail Resorts is committed to transparency. Readers can learn about our wind power purchase and how Vail Resorts is encouraging our guests and employees to choose clean energy at www.snow.com/windpower.

—Rob Katz
CEO, Vail Resorts Inc.
Broomfield, Colo.

CORRECTIONS & CLARIFICATIONS

"The Best Undergrad B-Schools" (Special Report, Mar. 19) should have listed Rutgers' New Brunswick campus as the location for the university's undergraduate business program. Separately, the business program at Cornell University was described as private. However, Cornell is a hybrid institution that is privately endowed and serves as New York's land grant university.

WHY EXCHANGE-TRADED FUNDS MAKE SENSE TO SO MANY

"THE TROUBLE WITH ETFs" (Personal Finance, Mar. 12) is misleading, presenting facts in a vacuum. Most fund-tracking error is driven primarily by the Securities & Exchange Commission and IRS rules that apply equally to exchange-traded funds and index mutual funds.

We find that our clients invest in ETFs because they provide cost-effective, tax-efficient access to markets. In most cases, there is not a comparable index fund to use or even to compare to (there are actually more ETFs than

index funds). If there are other traditional funds with access to the market or sector, they are likely going to have higher costs and be less tax-efficient, which leads to higher tracking error.

Instead of buying the ETF, investors could buy the individual securities, but investors face illiquidity and transaction costs and, with international securities, foreign ownership restrictions. In the end, this approach will lead to higher costs and tracking error as well.

—Lee Kranef
CEO, iShares at Barclays Global Investors
San Francisco

A SIDE EFFECT OF SLEEP APNEA

"WHEN THE GOING gets tough" (News & Insights, Mar. 12) prompts me to share my experience for the possible assistance of others.

It is dangerous to suggest that "everyone knows" that frequent male urination is prostate-related. My "naturally" enlarged 60-year-old prostate turned out not to be the cause of getting up frequently at night. It was my previously untreated sleep apnea. Apnea causes low, sometimes very low



ood oxygen levels, and this triggers
erious kidney hyperactivity to com-
ensate for the desaturation. I treated
y apnea, and now my large prostate
nd I sleep through the night.

—Doug Ellice
Gambrills, Md.

REGULAR JOE INVESTORS RE AT A HUGE DISADVANTAGE

HOMING IN ON trading abuses”
News & Insights, Mar. 12) asks the
question: “Do allegations that a UBS
trader sold info to hedge funds signal a
growing problem?”

Any prosecutor worth the title would
welcome an opportunity to press crimi-
nal charges if he had circumstantial
evidence of similar weight against a
suspect accused of a felony. How about
the Wall Street analyst who writes a
sweeping report on a subprime mort-
gage lender after the analyst’s employer
has profited from issuing questionable
securities for the same company, only
to have the lender company virtually
collapse immediately afterward?

Is it any wonder that innocent inves-
tors who do not have inside sources feel
that they do not have a chance against

the greedy people of Wall Street and are
leaving the market?

—Ingvar Eliasson
Ft. Myers Beach, Fla.

FOR DETERMINED DEADBEATS, JAIL TIME IS JUSTIFIED

I AM RESPONDING to the letter written
by Peter G. Hill in “Keeping divorced
parents from becoming deadbeats”
(Readers Report, Mar. 19), regarding
the article “Pepperoni, onions, hand-
cuffs” (UpFront, Feb. 26).

I couldn’t agree more with Mr. Hill’s
comment that “not too many parents
can meet their obligations from a pris-
on cell.” The problem that not only our
agency but all child support agencies
face, however, is that by the time a non-
payment of child support case reaches
the criminal level, with the impending
threat of jail or prison time, all other
options have been exhausted. It is at
this time that the threat, or reality, of
prison time is the only other choice a
judge is left with.

We have found that those parents who
are running from their child support re-
sponsibility are constantly coming up with
new and innovative ideas for eluding the

legal and moral responsibility of bringing
a child into the world. Therefore, as child
support agencies, we must also continual-
ly come up with new and innovative ideas
on how to locate these absent parents and
hold their collective feet to the fire.

—Cynthia S. Brown
Executive Director

Butler County Child Support Enforcement
Agency
Hamilton, Ohio

How to reach BusinessWeek

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Apple TV's Blurry Future

The best thing about Apple TV is that it tries to do for video what the iPod has done for music. The worst thing about Apple TV is that it tries to do for video what the iPod has done for music. The reason for this paradox: Apple's laudable effort to simplify video downloads by running everything through iTunes leaves too much good content out in the cold.

Although the iPod approach to music has come in for criticism, especially from European antitrust regulators, I think it has served consumers well. The iTunes Store is the only online source of purchased iPod music, but this does not limit customers, since nearly anything you can buy online can be gotten from iTunes. And the record companies have effectively forced all online stores to price tracks at 99¢, just like iTunes.

The video world, by contrast, is fragmented into incompatible sources and formats. (I'll be examining the digital video mess in more detail next week.) The \$299 Apple TV set-top box, designed to move video from your computer to your TV, can only play movies and TV shows from iTunes. That adds up to about 300 movies from Disney, Paramount, and Lionsgate and a couple hundred TV series. There are thousands of other shows and movies you can download from other sources, but they haven't been licensed to Apple, so you can't get them from iTunes. Unless iTunes becomes a universal source for video, as it is for music, Apple TV's simplicity and convenience will require unreasonable trade-offs.

THERE'S NO DISPUTING APPLE TV works very well within its limitations. It's a handsome white plastic-and-aluminum box about 8 inches square and a little over an inch high. You plug it in, connect it to a wide-screen digital TV (older sets need not apply), and run through a couple of menus that get you set up on a wired or wireless network. Apple TV then searches the network for PCs or Macs running iTunes. You choose one, then go to the computer to enter a code number that Apple TV displays. From then on, the videos, music, podcasts, or photos that you choose from iTunes will be copied automatically to Apple TV's 40-gigabyte hard drive.

Earlier efforts to bring online video to television sets have failed because streaming live video over a network doesn't work very well; even the fastest networks suffer glitches that spoil viewing. Apple solves the problem by storing content on the Apple TV box. And while that box syncs with only



**For now,
there's too
little content
available to
make the box
worthwhile**

(A DVD player would be a welcome addition, allowing Apple TV to replace a piece of gear in your video system instead of adding one more box.)

Wouldn't it be great if iTunes were a one-stop source for online video? One can always hope the studios will "get it, and just fall in line. But given the fractious and fragmented nature of the entertainment industry, I wouldn't bet on it.

one iTunes computer, Apple permits you to stream content stored on other computers in your home—with the quality lapses that entails.

If you want to watch on-demand high-definition video, you'll have to get it from your cable service. Apple TV can display HD, but there is almost no such content available. Apple claims "near DVD" quality for iTunes movies, but they don't come close to DVD images. iTunes TV shows all look a bit blurry, not even matching standard broadcast quality. The bigger and better your display, the worse it will look. On the

other hand, you can take that iTunes content with you on a laptop or iPod; you can't do that with on-demand cable.

Then there are all the things Apple TV can't do. It can't order downloads from the iTunes Store directly, only play content already in iTunes on a computer. You can't view streaming video directly from the Web, so no YouTube. You can't even stream a DVD being played on your computer over to your TV set.

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Mobile Broadcasting: *Mañana*

On Mar. 14, NBC Universal inked a wide-ranging deal with MobiTV, which claims 2 million subscribers, to beam TV to cell phones. If you take from this or any other announcements of late that TV on the cell phone, replete with significant audience and advertising, has arrived in the U.S. as a bona fide medium, I'm here to say you're wrong. And that you're wrong if you think

cell-phone TV is coming anytime soon.

American visitors to Asia often return with fierce technological envy over the whiz-bang handsets on display and the routine sight of nonchalant twentysomethings updating Web sites from their cell phones. The mobile phone in the U.S. is but a sad stepbrother of such devices. References to the U.S. as a Third World country when it comes to wireless service now approach cliché; even the cellular providers' commercials cede this point.

Yes, the iPhone looms. And there are Americans using cell phones for next-generation play, including watching video. It's just that there are very few of them. Interpublic Group's media-buying agency, Initiative, last year surveyed the U.S. and found that out of 213 million cell-phone users, only 12 million watched video clips, 6 million watched live TV, and just 3 million signed up for some kind of video-subscription service.

THE GLASS-HALF-FULL CROWD will see in those numbers nothing but upside. A host of smart media and marketing executives, however, see go-slow signs. Bad broadband infrastructure or cramped living quarters elsewhere in the world meant that mobile technologies took off there first. In the U.S., thanks to the spread of broadband, home PCs, and other factors (most American commuters don't use public transportation, where a digital time-killer comes in handy), we have a PC-based culture. That's why Web video took off here: Moving pictures on a TV-size screen are a familiar entertainment in digital clothes.

But mobile video is a whole new beast—the ill-fated Sony Watchman mini-TV from the '80s aside—and small-screen video was unknown before the advent of the Video iPod. Exactly how huge it will get remains uncertain. Exactly how ads will get placed around mobile video is even fuzzier, which is why some big marketers sound ultra-cautious. "The adoption of technologies takes longer than people expect," warns Jim Stengel, global marketing officer for Procter & Gamble. Adds Jeff Minsky, director of emerging media platforms at media buyer OMD Digital: "There's a groundswell of interest



[around mobile media], but I am very conservative about it.... It will be years before it's a huge part of the media mix.

Bear in mind that Web video is not yet a huge part of the media mix. According to research firm eMarketer, advertisers 2006 spent \$775 million on Web video while the total U.S. ad market is somewhere around \$280 billion. Granted, one reason Web-video spending is so small is that Google has yet to power up some kind of ad solution for YouTube (which had more than 34 million visitors last month, in case you were wondering).

But if that solution is elusive, what we make advertising around a much smaller

Ad placement on cell-phone TV remains a problem, and the technology isn't there yet

and more distant TV relative any easier to crack? The problem is compounded when one considers how personal a cell phone is. (Even the most devoted TV-phile's face isn't pressed against the screen.) This suggests that new rules of engagement for advertising, at least significantly rethought ads, are required.

And, of course, the marketing and advertising worlds

do not change quickly. Spending on Web advertising "is not growing as fast as the external evidence and hype would make you think," says Jeff Cole, director of the University of Southern California's Center for the Digital Future. In some form video on the cell phone is an obvious development. But so is paying for radio programming that's actually listenable, and Sirius and XM are billions of dollars in the hole. Something spectacular and bizarre will have to happen before a true and robust mobile medium is closer than several years away. ■

BusinessWeek.com



For Jon Fine's blog on media and advertising, go to www.businessweek.com/innovate/FineOnMedia.

BY JAMES C. COOPER

Say Goodbye to High Growth and Low Inflation

The economic Eden of the late 1990s and early 2000s is slowly fading

U.S. ECONOMY

The Federal Reserve always seems to be on the horns of one dilemma or another. It's the nature of the job: Controlling inflation quite often has negative implications for economic growth and unemployment. For now, the Fed's decision to hold its target interest rate steady at 5.25% on Mar. 21 looked

easy enough. The economy has slowed materially, and the policymakers believe that slowdown will allow inflation to ease. However, a growing number of economists believe, despite the cooler pace of growth, bringing inflation down to where the Fed wants it won't be so easy.

What seems to be happening is a gradual undoing of the high-growth/low-inflation Eden of the late 1990s and early 2000s. Back then, technological innovation fueled a speedup in productivity growth that helped the economy grow faster, create more jobs, and generate faster pay growth—all without boosting inflation. Meanwhile, the dollar was soaring, global growth outside the supercharged U.S. was sluggish, and there was a glut of production capacity. That meant falling prices of U.S. imports and plenty of foreign competition to help restrain prices of U.S.-made goods.

Times have changed—both at home and abroad—and ways that will make the Fed's job of controlling inflation more difficult than before. Even though the economy has slowed substantially over the past year, inflation is still higher than the Fed would like. Also, labor cost pressures continue to grow, as job markets tighten further and the unemployment rate keeps falling. In spite of new uncertainty stemming from the subprime mortgage mess, the Fed must maintain a tough stance against inflation, even if that policy risks magnifying the problems in housing and the economy. At the policymakers' Mar. 21 meeting statement showed, the Fed is still more concerned about rising inflation than it is about a weaker economy. Investors currently expect the Fed to cut rates later this year, but new forces at work in the economy will most likely rule that out.

GLOBAL CONDITIONS are now far less conducive to keeping inflation down. Growth is strong around the world, with little slack in production capacity. That's why central banks from Europe to Asia are lifting interest rates in an effort to preempt inflation. Even Japan is on its way to higher rates after years of deflation. And given the dollar's decline since early 2002, prices of imported goods other than fuels are up 2.5% over the past year, in

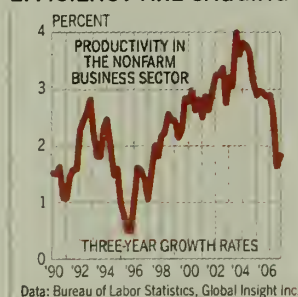
contrast to the late 1990s, when they were falling.

The most important forces working against the Fed are homegrown, most notably the recent slowdown in U.S. productivity growth. Up to now, strong productivity gains have given the economy more room to grow without pushing up inflation. The drop-off appears to be more than just a short-term blip caused by the ebb and flow of the business cycle. For the first time in a decade, the five-year growth rate of productivity is headed sharply in the wrong direction. It's down to 2.6% per year at the end of 2006 from a peak of 3.4% in 2004, and the slowdown is picking up speed. The three-year pace has dropped to only 1.8% annually, close to a 10-year low (chart).

WHY THE SLOWDOWN? For one reason, businesses are investing far fewer dollars in new equipment and

software as a share of overall gross domestic product. Even though companies are sitting on a ton of cash, while enjoying relatively easy financial conditions and pristine balance sheets, yearly growth in outlays for equipment, adjusted for prices, slowed to only 4.4% last year, the weakest pace in more than three years. Workers

GAINS IN CORPORATE EFFICIENCY ARE SAGGING



are clearly more productive than they were a decade ago, but the gains in their efficiency appear to be tailing off.

Also, much of current corporate outlays are for replacement of worn-out computers and other short-lived tech equipment. New computers are faster than older ones, but fewer innovative ways to use them may be another reason for smaller gains in corporate efficiency. Economists at JPMorgan note that the pace of technological innovation appears to be slowing down, citing a reversal in the pattern of prices of high-tech equipment and software. Rapid innovation in the late 1990s showed up in sharply falling tech prices, but the

trend now is a progressively slower rate of decline.

Researchers at Morgan are not alone in their conclusions. Economists at both Lehman Brothers and Barclays Capital have also argued that the slowdown in productivity and other factors will complicate Fed policy decisions. Until recently, economists generally believed strong productivity would allow the economy to sustain growth of a little better than 3% over the long run without pushing inflation higher. If so, then the current economic slowdown should be creating enough slack in the job markets and production capacity to ease pressure on costs and prices. That doesn't seem to be happening.

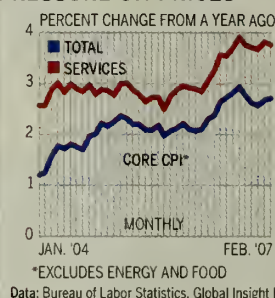
ASSUMING THE ECONOMY grows 2.5% in the first quarter, its pace over the past four quarters has dropped markedly, to 2.3%, from 3.7% the year before. If the economy were capable of sustaining 3% growth without boosting inflation, as was generally believed in recent years, then the unemployment rate would have risen by now. Instead, joblessness in February, at 4.5%, was 0.3 percentage points lower than it was a year ago.

Based on this and other labor market trends, economists at JPMorgan estimate the economy's long-run noninflationary growth rate is now no higher than 2.5%, and it might be lower than that. Such a downshift would mean the economy would have to grow below that rate for a considerable period for inflationary pressures in the labor markets and the economy to ease enough to allow the policymakers' preferred inflation gauge to slip back into their 1% to 2% comfort zone.

The central bank has projected inflation will end the

year in the range of 2% to 2.25%, before sliding below 2 in 2008. However, the rate in January was 2.3%. It has been at or above 2% for nearly three years, and the recent trend is up, not down. As of February, inflation measured by the core consumer price index also remains elevated at 2.7%, held up by service prices (chart).

SERVICES KEEP THE PRESSURE ON PRICES



The bottom line: The Fed may have to squeeze the economy harder than it has in the past to assure core inflation comes back into the policymakers' comfort zone. If inflation does not behave according to the central bank's optimistic expectations, the Fed could face a credibility problem on Wall Street. However, a tough stand

against inflation could magnify the problems in housing and in the economy generally.

For investors, the implications of this changing economic landscape could be significant: Growth in corporate earnings may already have peaked, and rising labor costs may pinch profit margins. Plus, outside of a recession, the Fed would have less leeway to cut rates, and any rebound in the economy as the housing slump subsides might even be met with a new round of rate hikes. All this portends a much tougher investment climate in the years ahead. ■

CONSUMERS

Home Equity: The Party May Be Over

WILL THE HOUSING collapse deal a major blow to consumer spending? The moment of truth is fast approaching. Weak home sales, stagnating or falling house prices, and tighter lending standards are limiting the amount of cash households can obtain by tapping into their home equity. Some economists believe this cash strongly supported spending in recent years.

In the fourth quarter of 2006, the amount of this equity extraction fell to 2.1% of aftertax income, according to investment bank UBS. What's more, a disproportionate share of subprime borrowers, especially those with adjustable-

rate mortgages, turned to their homes for extra cash.

There have been few signs of weaker consumer spending, but UBS economist James O'Sullivan believes that could soon change. So far, most of the dropoff in equity extraction has been from fewer home purchases leading to less money left over after sales. But now funds

from home-equity loans and cash-out mortgage refinancing are falling. Money from such loans is "more likely to be turned into spending promptly" than funds from a home sale, he says. After all, many sellers turn around and use the cash to buy another home.

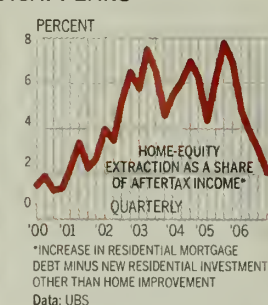
The effects on

spending from falling home-equity extraction also occur with a lag, and any early impact may have been offset by lower energy prices late last year. O'Sullivan expects the drag from reduced home-equity extraction to emerge in the second quarter, leading to a roughly 0.5% drag on consumer spending this year. And Jan Hatzius at Goldman Sachs believes the drag will only get larger in 2008.

However, other economists remain optimistic. Solid job growth outside of construction and manufacturing, healthy income growth, and the lagged effect of past wealth gains are expected to make for the decline in equity extraction. Also, higher-income households make up a majority of spending and are less likely to be affected by the housing downturn. We should soon know which side has it right. ■

—By James Mehring in New York

A HOUSING WINDFALL DISAPPEARS



Photographed by Patricia von Ah at the Reno Air Races, Reno, Nevada.

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PROFESSION: PILOT CAREER: ACTOR

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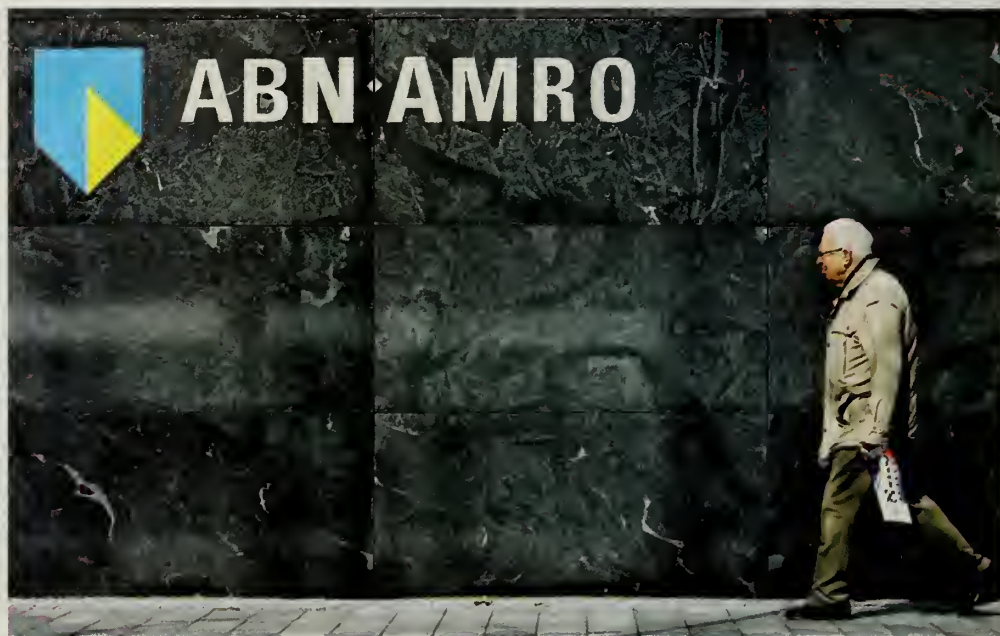


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The Business Week

NEWS YOU NEED TO KNOW EDITED BY HARRY MAURER



WILL BARCLAYS GO DUTCH?

The dealmaking in Europe just keeps getting hotter. On Mar. 20, **ABN Amro**, the Netherlands' No. 1 bank (photo, Amsterdam headquarters), said it's talking with Barclays about a merger to create a \$155 billion institution, the world's fifth-largest bank by market value. If the \$80 billion deal goes through, it would mark Europe's biggest-ever cross-border banking tie-up. The new entity would be based in Amsterdam, with the Brits naming a CEO and the Dutch a chairman.

ABN is pining for a suitor to fend off hedge funds and other shareholders that have called for a breakup. The bank's stock has stagnated as it has struggled to wring profits from far-flung operations. But a marriage with Barclays is hardly a sure thing. Other global behemoths, such as **Citigroup** or **HSBC**, might choose to make a run at ABN, or Dutch regulators might do their best to nudge it into the arms of local bank **ING**.

See "Smart money is chasing Eurodeals," page 45

Shakeup at Motorola

No sooner had the rumor mill made a Motorola buyout of **Palm** look inevitable than bad news flowed from Schaumburg, Ill. Motorola on Mar. 21 cut its profit guidance from a consensus of 18¢ a share to 7¢ because of slowing revenue. To fix the biz, it named networks unit chief **Greg Brown** president and COO and **Thomas Meredith**, a Motorola director, CFO. It also will boost its share-buyback

program, which may help fend off **Carl Icahn**.

ONLINE "Motorola's Zander: On Razr's edge," www.businessweek.com/go/tbw

Enron: Class Dismissed

A lawsuit seeking billions in compensation for Enron shareholders has gone off the rails. On Mar. 19 a federal appeals court ruled that the case against Enron's banks

and securities firms could not proceed as a class action. Defendants **Credit Suisse Group**, **Merrill Lynch**, and **Barclays** are no doubt elated at the decision, which concluded that as "secondary actors" they could not be sued by private investors for Enron's deceptions.

A Chinese Airliner?

On Mar. 19, Beijing said it's laying plans to build its

own 150-seat commercial jet by 2020. Ambitious? Sure. Realistic? Maybe. No one disputes China's ability to produce a credible airliner, but making it fly in the marketplace is another thing. It would find domestic buyers, no doubt, but in an industry that wants to slash the fuel and operating costs of commercial jets, innovative technologies trump a low-cost labor advantage.

ONLINE "Will China join the jet set?" www.businessweek.com/go/tbw

Blackstone's About-Face

Say what? Just when people were starting to believe private equity's paeans to the joys of going private, CNBC reported on Mar. 16 that **Blackstone Group** may soon list 10% of itself in an IPO that would value the firm built by CEO **Steven Schwarzman** and Chairman **Peter Peterson** at \$30 billion. Blackstone wouldn't comment.

ONLINE "A public Blackstone could do ever-larger deals," www.businessweek.com/go/tbw

No Wal-Mart Bank

So much for the First National Bank of Wal-Mart. The retail colossus said on Mar. 16 that it had pulled its controversial application to operate an industrial-loan company. Wal-Mart said it wanted sole to cut credit-card transaction costs, but the effort inflamed community-banker groups and some congressional leaders who contended it was the first step to operating full-service banks within the company's 4,000 U.S. stores.

Detroit Doldrums

Assorted auto news: On Mar. 13 the **United Auto Workers** said it will fight if **DaimlerChrysler** tries to sell its Chrysler unit to a private equity firm that only wants pieces of

or intends to break it up. Ieantime, as Nissan sales and profits have slowed in Japan and the U.S., Renault-Nissan CEO Carlos Ghosn on Mar. 16 gave up the job of personally managing Nissan North America. and General Motors on Mar. 15 said accounting "complexity" forced it to restate earnings back to 2000.

New Bid for CBOT

Love over, Merc. On Mar. 15, IntercontinentalExchange, the seven-year-old upstart energy-futures market in Atlanta, bid \$9.9 billion in stock to buy the Chicago Board of Trade, dumping an \$8 billion cash-and-stock offer by the Chicago Mercantile Exchange. The Merc insists its deal is superior but may have to sweeten it.

ONLINE "Why ICE may win the CBOT,"

www.businessweek.com/go/tbw

Project One CEO

Blockbuster boss John Antioco lost his war of attrition with shareholder activist Carl Icahn, board member and 15.8% owner of the video chain. On Mar. 20, Antioco said he'll leave at the end of 2007, a year before his contract expires. His parting gift? A \$3.1 million

2006 bonus and nearly \$5 million in severance pay, a deep discount from the \$13.5 million his contract allowed in case of an early termination and the \$7.65 million in 2006 bonuses under the company's existing policy.

ONLINE "No blockbuster deal for Antioco,"

www.businessweek.com/go/tbw

Virgin May Take Off

After three years, low-cost airline Virgin America is finally on the runway. On Mar. 21 the Transportation Dept. gave tentative approval to the startup's business plan. The brainchild of British billionaire Richard Branson, whose Virgin Group owns 25%, Virgin America has had to perform loop-the-loops to convince regulators and rivals that it's U.S.-owned and managed.

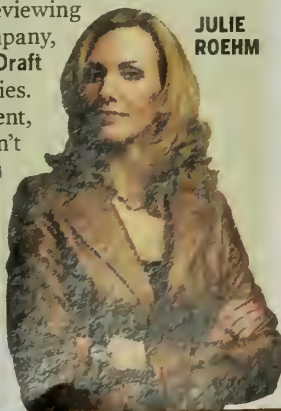
CVS Gets the Nod

Shareholders of prescription-benefits manager Caremark Rx on Mar. 16 voted for a \$27.6 billion buyout by drugstore giant CVS, spurning a \$28.4 billion offer from rival Express Scripts. The vote ended a tussle that erupted after CVS' initial all-stock bid last November.

E-MAILS OF THE WEEK

The hostility between Wal-Mart Stores and Julie Roehm, the high-profile marketing executive it fired in December, got even nastier on Mar. 19. Wal-Mart filed a counterclaim to Roehm's wrongful-dismissal lawsuit in which it bolstered its contention that it canned her for having an affair with a subordinate and violating the company's strict conflict-of-interest code with suppliers. The filing relies largely on e-mail exchanges between Roehm and her direct report, Sean Womack. The suit says Womack's wife discovered some exchanges on his home computer. Roehm says in one: "I think about us together all the time. Little moments like watching your face when you kiss me." Wal-Mart also alleges that Roehm and Womack, while reviewing advertising agencies for the company, held discussions with one of them, Draft FCB, about employment opportunities. Wal-Mart declined further comment, and Roehm and Womack couldn't be reached. Roehm's lawyer, John Schaefer, said in a statement that "Wal-Mart deliberately chose to take the e-mails out of context." He called the case "nothing more than a smear tactic."

JULIE ROEHM



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THE INTERNET

WHERE IS MICROSOFT SEARCH?

Its stumbles on the Web could open the door for rivals to come after its core business

BY JAY GREENE

TIME HAS ALWAYS SEEMED to be Microsoft Corp.'s ally. In the company lore, the software giant takes three cracks at a market before establishing supremacy. The Windows operating system stumbled for years before achieving domination; so did Microsoft's server software.

But when it comes to developing a viable Internet strategy, Microsoft may be running out of time. It has long trailed Web leaders Google Inc. and Yahoo! Inc., in the use of its search engine and in search-ad sales. Now it's losing ground. In February, 2005, Microsoft's MSN Search accounted for nearly 14% of all Web searches, compared with a 46% share for search leader Google, according to research firm Nielsen//NetRatings. Just two years later, Microsoft's rebranded Windows Live Search has a 9.6% share, compared with Google's nearly 56%. That amounts to nearly 300 million lost searches per month. The sense that Microsoft is slipping was reinforced with a recent shuffling of top executives.

Microsoft's search problems present it

with a huge quandary. The company's revenue from online advertising is relatively small—just \$836 million in the first six months of the fiscal year ending in June, vs. \$5.9 billion in sales of the Windows PC operating system. But the Web is increasingly the place where computing gets done. Everything from e-mail to customer-relationship management applications is moving from programs on a PC to services on the Net. Meanwhile search advertising is exploding: Piper Jaffray & Co. says it should hit \$44.5 billion by 2011, up from \$15.8 billion in 2006.

If Microsoft can't keep pace, it risks seeing its Windows and Office software franchises erode as Google and others launch Web-based rivals. "It behooves Microsoft to be there," says Charles Di Bona, an analyst with Sanford C. Bernstein & Co. "If they don't get there, it gives others a platform from which to attack Microsoft's core business."

Just as troubling, Microsoft's search problem reflects its approach to new markets in general. It spends little time focusing on tiny, emerging niches that generate little, if any, sales. But those are precisely the markets that can quickly

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blossom on the Net into meaningful businesses. "Bill [Gates] and Steve [Ballmer] and the leadership don't understand the value of small things," says Robert Scoble, a former Microsoftie whose blog recently took the company to task for its Web missteps. "That cripples their entire Internet strategy from the start."

Microsoft has already squandered much of the time it spent developing the search business. Until February, 2005, it licensed search technology from two companies, Overture and Inktomi. Then it launched a homegrown search engine, saying at the time that it would win over Web searchers with results that were more relevant than Google's. Last fall, Microsoft Chief Executive Steven A. Ballmer told *BusinessWeek* editors and reporters: "I think in the next three years, people will say, 'Hey, these guys are really a major player in online consumer and advertising.'"

There are a number of reasons that hasn't happened yet. First, Google has performed near flawlessly. Early on, Google used its simple Web site to cement the impression that to search is to "Google." And because more people search there, Google has more data with which to target relevant ads. The result: By some estimates, Google nets at least 50% higher revenue per search than No.2 Yahoo and other search sites—allowing Google to keep investing more in improvements. For instance, on Mar. 21 it revealed a new program to give advertisers the opportunity to pay only when someone responds to an ad—by purchasing a product, filling out a form, or some other action—rather than merely when they click on it. That may be more attractive to advertisers who want concrete results.

Meanwhile, Microsoft has managed to confuse searchers. It elbowed into the search business on the back of its MSN franchise, a modestly successful online services business known mostly for its dial-up Internet access operation. Then Microsoft muddled its message in November, 2005, when it launched the "Live" initiative designed to turbocharge Web services, including search, with programs running on PCs. But Microsoft continued to use the MSN prefix on some Web sites, such as its portal and shopping page, while using Windows Live for its e-mail



OUTSIDE HELP

Berkowitz was hired to rev up Microsoft's Web business

Sullivan, editor-in-chief of searchengine-land.com, which covers the business.

For its part, Microsoft says Windows Live services are those users can personalize, while MSN ones are preprogrammed content. Concedes Microsoft spokesman Adam Sohn: "We could have been a little crisper." Steve Berkowitz, who was hired last May to rev up the Web business as senior vice-president for Microsoft's Online Services Group, declined to comment.

EXECUTIVE SHUFFLE

WITH PRODUCT challenges comes the inevitable Microsoft executive shuffle. Blake Irving, vice-president of the Windows Live Platform group, sent out an e-mail to his colleagues on Mar. 5 announcing plans to leave the company later this year to travel the world. Three days later, Christopher Payne, vice-president of Windows Live Search, who spearheaded search development efforts, announced he would be leaving to launch his own company.

Then on Mar. 21, Microsoft created a job at the same level as Berkowitz' to oversee the search and Web ad business. The idea is to increase the urgency of search by moving it up in the organizational structure. Satya Nadella, a vice-president who just six months ago took over the company's small-business software unit, will run the combined group, reporting directly to

Kevin Johnson, president of Microsoft platform and services division.

There's plenty of pressure to make the fix stick. Last May, Microsoft launched adCenter, a technology that takes demographic data (gender, age, Zip Code) Web surfers who sign up for various MSN and Windows Live services and lays it over their search queries. That lets advertisers tailor ads to specific types of customers and should allow Microsoft to charge more. But the strategy packs a punch only if Microsoft boosts its share of search.

Microsoft could still do that. It is betting search will move beyond the all-purpose Web site where users plug in a query for any bit of information. That's not a bad idea; many analysts believe the search world will fragment into vertical sites that focus on niches. The eye-popping success of YouTube Inc., now owned by Google, is one example. More than just a place to show off your creations, YouTube has become a place to search for videos. Microsoft announced plans in February to buy Medstory Inc., a health-care search engine for consumers. And on Mar. 14 it said it would buy Tellme Networks Inc. for what one analyst estimated to be more than \$1 billion. Tellme should give Microsoft a lead up in the emerging market for voice-activated search over a mobile phone.

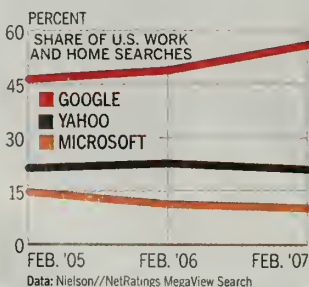
Microsoft is also trying to nudge its massive customer base over to its search engine. On Mar. 13 it struck a deal with PC maker Lenovo Group to preload machines with the Windows Live toolbar, which leads users into its search engine. Microsoft also launched a "trial program" where it offers some large businesses service and training credits—free \$2 to \$10 per computer—to get employees to use Windows Live Search.

Sure, that amounts to buying business. But with all it has at stake in search, Microsoft will take it any way it can. ■

—With Robert D. Hof in San Mateo, Ca

WEB WOES

Microsoft keeps losing ground to search rivals



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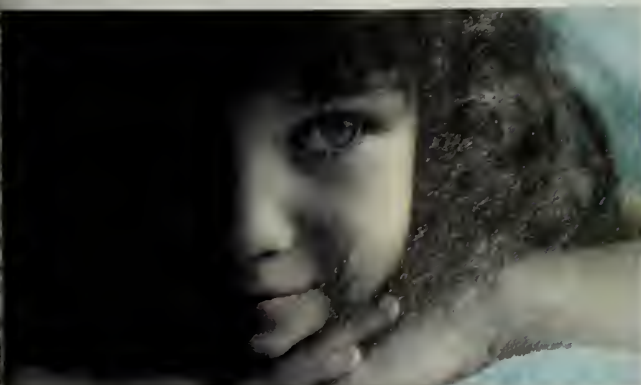


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THE PRESIDENTIAL RACE

ROMANCING THE STREET

Election season is now in full swing, based on Beltway traffic to investment banks

BY DAVID HENRY
AND EAMON JAVERS

THE MANHATTAN HEADQUARTERS of investment bank Evercore Partners Inc. isn't a place you'd expect to find people debating campaign strategies. But the firm hosted an historic gathering a few weeks back: the first meeting of Senator Hillary Clinton's (D-N.Y.) economic advisers, led by former Deputy Treasury Secretary and current Evercore Chairman Roger C. Altman. Also there: Steven Rattner, a partner at investment firm Quadrangle Group; Blair W. Effron of investment adviser Centerview Partners; and Stanley Schuman of investment bank Allen & Co.

The team is just beginning to refine Clinton's positions on the key issues facing Wall Street. Even though Clinton telegraphed her interest in running for President years ago, the early start to the 2008 campaign season caught

the group off guard. "I don't think we were prepared to be starting this early," says a source familiar with the meeting.

It's a sentiment shared by most of the power brokers advising big Presidential candidates. Says Cesar Conda, an economic adviser to former Massachusetts Governor Mitt Romney and a partner at lobbying firm DC Navigators: "We could have a nominee by Feb. 5 of next year, which means we have to accelerate the development of our policy positions much faster than a lot of us are used to."

Sure Iowa, New Hampshire, and California are important. But another crucial contest in the most wide-open election season since 1928 is taking place right now on Wall Street. A mating ritual is under way that will determine who raises enough money to get his or her party's nomination—and which Wall Street backers have the most influence on policies affecting the economy, regulation, and global markets. Bear Stearns Cos. already has invited seven major

candidates to its Midtown Manhattan headquarters for presentations and Q&A with more than 400 managing directors over the next several weeks. It set up the tour after being swarmed by election fundraisers. (This way, Bear makes friends with everyone.) Wall Streeters, says Mary Mallin, veteran GOP strategist and adviser to Vice-President Dick Cheney, "never are weighing in." Her advice: Speak up loudly now for the greatest impact.

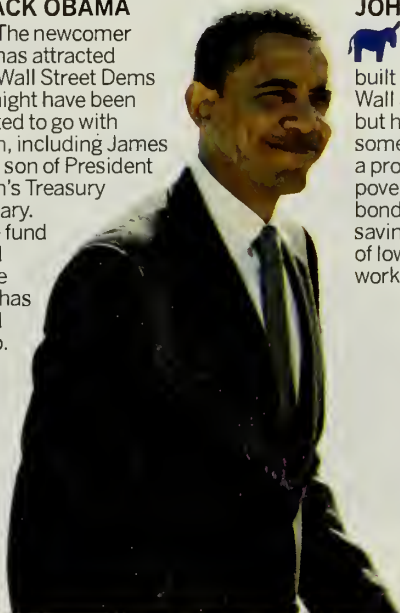
'MAKE THE PIE BIGGER'

AS THE LISTENING tours crank up, the candidates are hearing what financial care most about: global trade, federal spending, and regulation of financial markets. Executives also want reassurance that candidates can make smart decisions in times of uncertainty, a trait bankers and traders prize in themselves.

With the horse-trading between Wall Street and the candidates in full swing, some key issues are moving to the foreground. Perhaps the most important

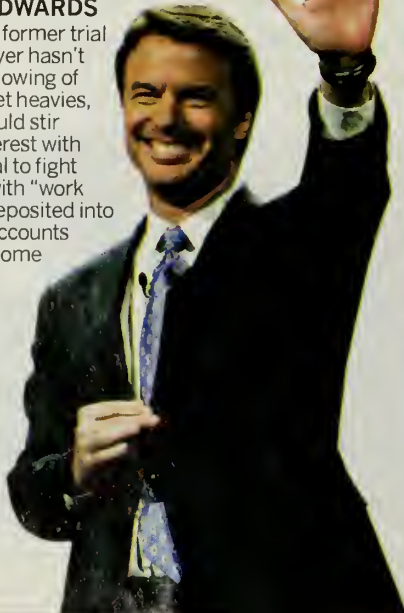
BARACK OBAMA

 The newcomer has attracted some Wall Street Dems who might have been expected to go with Clinton, including James Rubin, son of President Clinton's Treasury Secretary. Hedge fund legend George Soros has signed on, too.



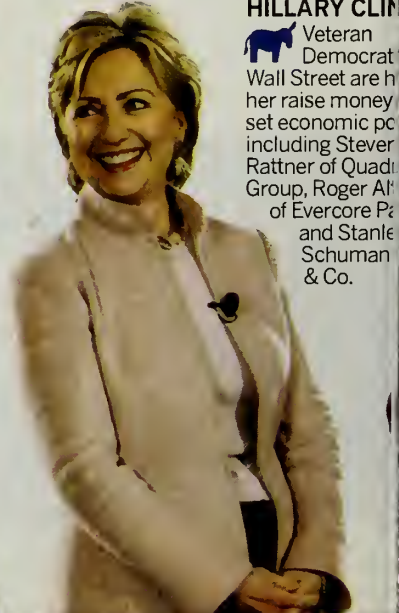
JOHN EDWARDS

 The former trial lawyer hasn't built a following of Wall Street heavies, but he could stir some interest with a proposal to fight poverty with "work bonds" deposited into savings accounts of low-income workers.



HILLARY CLINTON

 Veteran Democrat Wall Streeters are helping her raise money to set economic policy, including Steven Rattner of Quadrangle Group, Roger Altman of Evercore Partners, and Stanley Schuman of Allen & Co.



MATING RITUAL As Presidential hopefuls raise funds, bankers make their priorities heard

held by China and Japan. "How," she asked rhetorically, "can we negotiate fair, pro-American trade agreements...when we sit across the negotiating table not only from our competitor but our banker as well?"

Beyond simple tariffs issues, bankers are also pushing for more uniformity in trading and accounting regulations. And they're worried about regulations that many believe threaten the competitiveness of U.S. financial markets. New York Stock Exchange CEO John A. Thain, a national co-chair of finance for the McCain campaign, was one of the first to

complain to Washington that many of the Sarbanes-Oxley Act requirements on publicly traded companies hurt Wall Street and helped foreign markets. And Romney, a founder of the private investment firm Bain Capital, says SarbOx is "driving away IPOs, depressing jobs, and requiring billions of unnecessary cost."

Another contentious issue is hedge fund regulation. The Street wants Congress, which has been holding hearings on the secretive investment pools, to avoid the temptation of imposing heavy burdens that could prompt funds to move overseas. Some candidates have weighed in already. Obama co-sponsored a bill earlier this year that would increase reporting requirements for hedge funds. But he hasn't called for full-out Securities & Exchange Commission regulation.

The 2008 campaign should see plenty of bipartisan unity on the issue of fiscal responsibility. The federal budget deficit

hit \$248 billion last year, nearly a half-trillion-dollar swing from the \$236 billion surplus of 2000, according to the Congressional Budget Office. Wall Street wants an end to the deficits, and by and large the candidates are promising just that. Romney recently vowed that, if elected, he would cap nondefense discretionary spending at inflation minus 1%.

Like most voters, Wall Streeters are also trying to size up candidates' personal qualities. At a meeting on Feb. 3 in Manhattan, bankers grilled Obama about how he makes decisions. Present were Eric Mindich of Eton Park Capital, Frank Brosens of Taconic Capital Advisors, Michael Froman of Citigroup Alternative Investments, and James S. Rubin of JPMorgan Chase's private equity fund, among others. Obama said a President must be able to make important decisions with little information. He cited his 2002 position against the Iraq invasion, which he arrived at without seeing the intelligence reports. That message "appealed to them because it was similar to the decisions that they make every day about risk, returns, and probability of various outcomes," says Froman, a law school classmate of Obama.

Similarly, Dalio, the Bridgewater chief who trades currencies, debt, and stocks around the world, likes the way McCain arrives at his positions. It's different from relying on academic knowledge or creative brilliance, says Dalio. "It is the ability to intelligently analyze and make decisions from a practical perspective.... A successful President must have a lot of practical intelligence." ■

CAMPAIGN WATCH



MITT ROMNEY

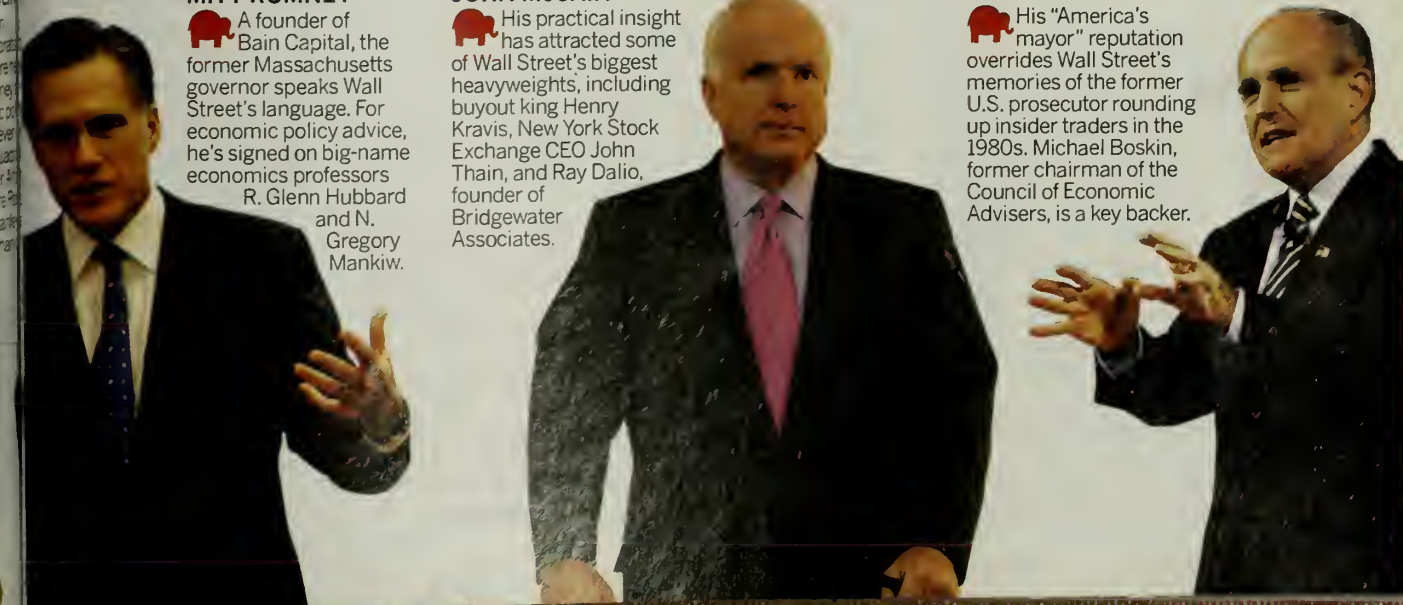
 A founder of Bain Capital, the former Massachusetts governor speaks Wall Street's language. For economic policy advice, he's signed on big-name economics professors R. Glenn Hubbard and N. Gregory Mankiw.

JOHN MCCAIN

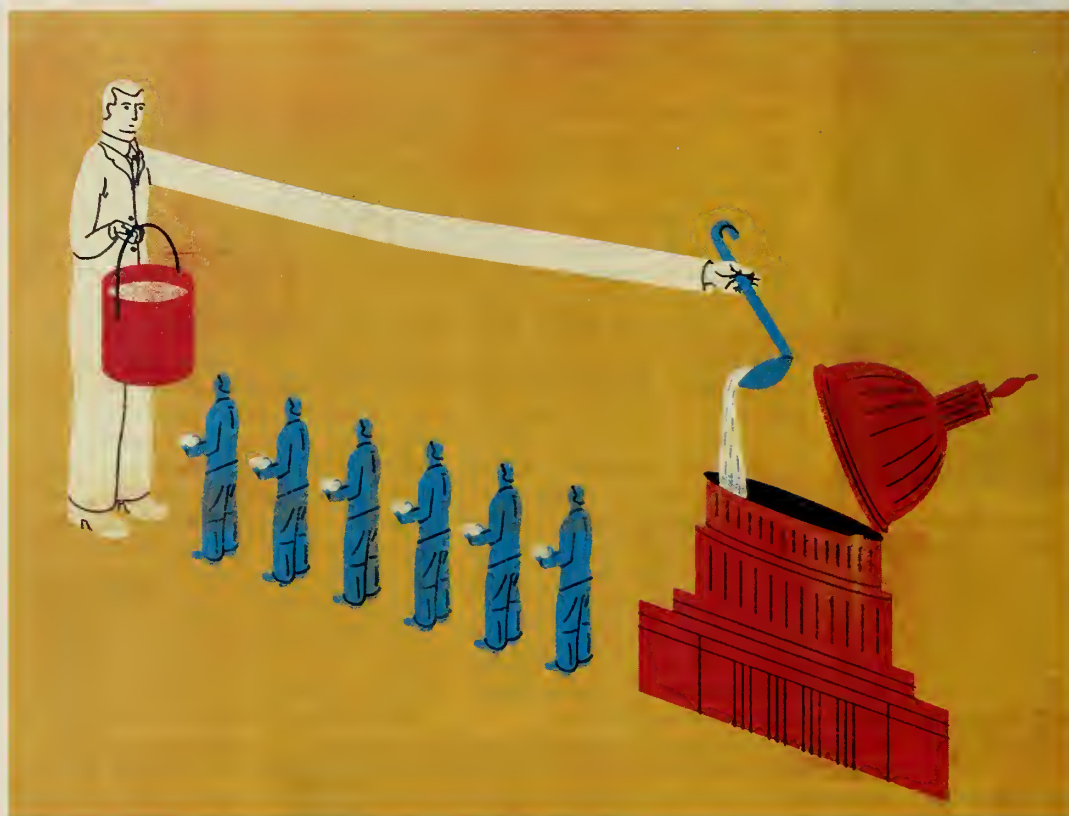
 His practical insight has attracted some of Wall Street's biggest heavyweights, including buyout king Henry Kravis, New York Stock Exchange CEO John Thain, and Ray Dalio, founder of Bridgewater Associates.

RUDY GIULIANI

 His "America's mayor" reputation overrides Wall Street's memories of the former U.S. prosecutor rounding up insider traders in the 1980s. Michael Boskin, former chairman of the Council of Economic Advisers, is a key backer.



(BOTTOM LEFT TO RIGHT) ROB CARL/AP PHOTO; RICH PEDRONCELLI/AP PHOTO; ROBERT SULLIVAN/APF/GETTY IMAGES; JIM COLE/AP PHOTO; ROGER L. WOLLENBERG/UP; JASON MOORE/ZUMA PRESS; (PARTY ICONS) RAY VELLA/BW



SCANDALS

PHILANTHROPY, FANNIE MAE STYLE

The mortgage giant's generosity frequently came with strings attached

BY DAWN KOPECKI

THERE WAS NOTHING remarkable about the announcement on Feb. 23 that Fannie Mae was shutting down its foundation at the end of April. As part of a broader alignment of resources, CEO Daniel Mudd said, Fannie would move all philanthropic work in-house to "better serve our mission." But the mortgage giant might have had another reason for closing the nation's largest nonprofit focused on low-income housing: increased scrutiny by lawmakers and regulators.

BusinessWeek has learned that the Internal Revenue Service is looking into Fannie's

charitable work and related tax deductions over the years. According to former executives at Fannie and documents reviewed by *BusinessWeek*, the IRS is trying to determine whether the company used the foundation and other charities to curry favor with members of Congress and whether it improperly wrote off those costs. Last year the Senate Finance Committee started investigating alleged abuses of the foundation's tax-exempt status and accusations that the nonprofit was, in effect, another lobbying and marketing arm for Fannie. "The foundation's closing doesn't answer

questions about potential inappropriate political activity in the past, and it could raise questions about future transparency from Fannie Mae for its charitable activities," says Iowa Senator Chuck Grassley, the top Republican on the Senate Finance Committee. The IRS and the foundation decline to comment.

Created in 1979, the Fannie Mae Foundation has given out more than \$1 billion. In 2000 it awarded \$34.5 million in grants to 30 nonprofit groups, mostly welcomed by small charities that often operate on a shoestring. "They've been critical[ly important]," says Bart Harver, chairman and CEO of the nonprofit housing developer Enterprise Community Partners, which has received more than \$

million from the foundation since 2000.

Yet that generosity came with strings attached, say some former Fannie executives, grant recipients, and nonprofit advocates. In applications for funding, nonprofits were asked to list their political contacts in a section labeled "franchise value." Those so-called affinity contacts—a former congressional aide, a lawmaker's barber, a senator's pastor—helped populate a database at Fannie that at one point had roughly 4,000 people with a direct connection to a member of Congress. "They were using charitable grants to strengthen, advance, and carry out the political and lobbying agenda," says Fred Wertheimer, president and CEO of campaign finance watchdog Democracy 21. "It was the political equivalent of a quid pro quo." Says Bruce Marks, CEO of the Neighborhood Assistance Cor-

poration of America, a low-income housing advocate: "Major institutions rely on Fannie Mae and understand the funds are contingent on public support for its policies. Fannie Mae has intimidated virtually all of the rest into remaining silent."

The foundation appears to have walked a fine line in its dealings with politicians. It regularly hosts

The IRS is examining Fannie's charity-related tax deductions



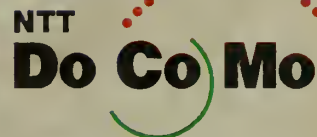
So Radical Today, So Obvious Tomorrow

When the Romans constructed their mighty aqueducts to bring water into towns and cities nearly two thousand years ago, they changed the everyday lives of the inhabitants out of all recognition. The world's leading mobile operator NTT DoCoMo is also working to build a new "Lifestyle Infrastructure" for the information age: an infrastructure that will have an equally dramatic impact on our lives, making them richer, safer, and more convenient.

It was two years ago that NTT DoCoMo first reconceived the mobile phone as a "Lifestyle Infrastructure" tool. Now over 18 million users* have handsets that can act not just as communication devices, but also as "e-wallets" that incorporate e-money, credit card, even airline and train ticket functions.

In NTT DoCoMo's vision, mobile phones with integrated "e-wallet" functions will soon be playing as essential a role in our everyday lives as aqueducts did for people in the Roman world. It's a bold claim, but, as history shows, today's radical breakthrough often becomes a familiar part of tomorrow's landscape.

* as of December 2006



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regional housing fairs and paid for politicians to attend a three-week management program at Harvard University's John F. Kennedy School of Government. It has also spent millions supporting politically aligned groups such as the Congressional Black Caucus Foundation, Congressional Hispanic Caucus Institute, Metropolitan Mayors Caucus, and National Conference of State Legislatures. The Fannie Mae Foundation has, according to tax filings, donated at least \$600,000 to the Congressional Black Caucus Foundation since 1989, money used in part to sponsor events like the CBCF's golf and tennis tournament. "They've been an important player," says Representative Mel Watt (D-N.C.), the past chairman of the Congressional Black Caucus and a current member of the CBCF. "[We] have worked closely with Fannie Mae or the foundation periodically to do things, sponsor housing fairs, [and] press Fannie Mae to provide support for housing initiatives in [members'] districts."

SWITCHING HATS

THE CONCERN IS whether such efforts were made to bolster Fannie's business more than to advance philanthropic goals. Critics say the foundation helped to reinforce ties with various congressional groups forged by Fannie's in-house lobbyists. At times the two seemed indistinguishable: They often sponsored events in tandem. Both were big donors to the CBCF's annual awards gala in 2003 and a similar black-tie event for the Congressional Hispanic Caucus Institute in 2002. In 1998, then-CEO Jim Johnson hosted the opening ceremony of a lobbying and public relations office in Oklahoma, an event attended by former Oklahoma Governor Frank Keating and then-Senator Don Nickles (R-Okla.). But wearing his other hat as the foundation's chairman, Johnson also took the opportunity to announce \$125,000 worth of grants to local charities.

It appears as though the investments have paid off. When Fannie's regulator, the Office of Federal Housing Enterprise Oversight, in 2004 accused the company of manipulating its earnings figures, CBC member William Lacy Clay (D-Mo.) declared the attack on then-CEO Franklin D. Raines, who is black, a "political lynching." Clay, one of many CBC affiliates to come to Fannie's defense at the time, declined to comment. Fannie also called on allies to oppose a legislative push in

It may have walked a fine line in its dealings with politicians

Fannie's Other Lobbying Arm

The company's foundation is feeling the heat from investigations into alleged abuses of its nonprofit status. Here's how it may have blurred the line between philanthropy and lobbying.

SPONSORED black-tie galas, golf tournaments, and educational programs for politically aligned charities

REQUIRED organizations that applied for funding to divulge their political contacts

PUT PRESSURE ON grant recipients to publicly support Fannie

FOOTED THE BILL for the bulk of Fannie's estimated \$50 million annual ad campaign during much of the 1990s



CEO MUDD:
Moving charity work in-house will "better serve our mission"

2002 to end Fannie's longtime exemption from registering its stock and debt with the Securities & Exchange Commission. Its lobbyists helped draft statements issued by then-CBC Chairwoman Eddie Bernice Johnson (D-Tex.), Congressional Hispanic Caucus member Silvestre Reyes (D-Tex.), and former Representative Robert Ney (R-Ohio), Fannie and the politicians each admitted after the fact. A spokeswoman for Johnson stands by the 2002 comments: The congresswoman works with many groups, but "we are careful to make sure her words appear in print."

A spokeswoman for Reyes said he works with a lot of organizations. Ney is in jail on an unrelated matter and could not be reached for comment.

The Fannie Foundation in some cases played an overt marketing role. During much of the 1990s it covered the bulk of Fannie's estimated \$50 million annual advertising budget. That was possible because the foundation received a series of IRS exemptions from the usual restrictions on nonprofit ad campaigns that promote the corporate parent. Most of the ads highlighted how Fannie made homeownership possible. But after TV spots, featuring a minority couple worried that a Senate bill would prevent them from getting a mortgage, ran the week before votes were scheduled on the legislation, lawmakers accused Fannie and the foundation of coordinating the marketing in an effort to derail the bill. Although Fannie said it paid for those ads, they were eventually pulled since then, Fannie and the foundation have discontinued almost all national TV advertising.

For years, Fannie's special status as a government-sponsored entity made it seem untouchable. That

perception changed three years ago: allegations of accounting irregularities, aggressive lobbying, and management missteps surfaced. In 2005 the company laid off 20 lobbyists and publicists after a probe by the Housing & Urban Development Dept. found that it had improperly used staff "to obtain access to and influence members of Congress." In May 2006, it settled its accounting issues with the SEC for \$400 million. On Mar. 9, this year the House introduced a new bill to overhaul the rules that govern Fannie. Now, as the company fights to rebuild its damaged reputation, the foundation may have become another headache Fannie just didn't need. ■

—With Adrian Reeves in Washington



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WEB 2.0

TWITTER: ALL TRIVIA, ALL THE TIME

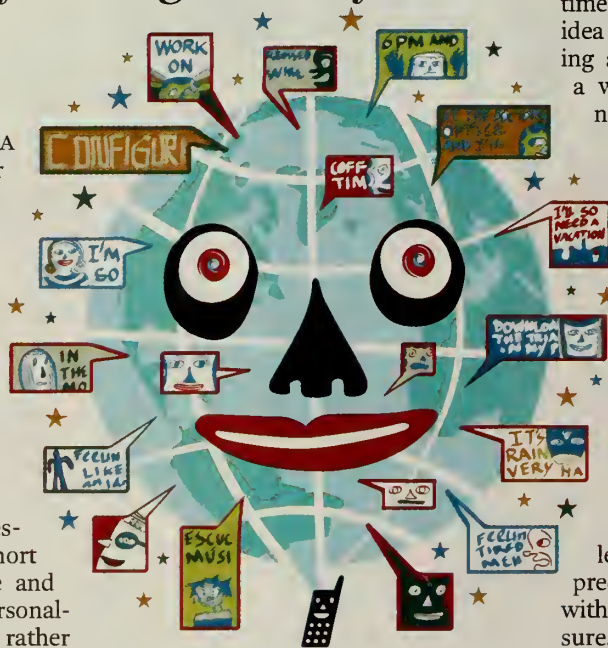
The service's followers love its quotidian tidbits. Others cry: Enough already!

BY HEATHER GREEN

IF YOU HAVEN'T TAKEN A stance on the raging Twitter debate, don't feel bad. The free, fledgling Web service counts only around 80,000 subscribers. And while Twitter has been around for a year, things didn't start heating up until early March. Since then, bloggers have debated whether Twitter represents a leap forward in online communication—or the faint, first chirps of an attention apocalypse.

Twitter is a twist on instant messaging. It lets subscribers send short updates about their every move and thought to the cell phones and personalized Web sites of groups of folks, rather than just to individuals. When it was launched a year ago by Obvious Corp., a startup formed by blogging technology pioneer Evan Williams, the idea was to offer a simple service people could use to send text message updates to the cell phones of their friends. Late last year, the service was tweaked to let users get and send updates without first entering their phone number. And they could send them from instant messaging services and a personalized Twitter site. That's when bloggers started buzzing. Even digi-savvy Presidential candidate John Edwards signed up, sending out updates such as "Washington D.C. today. About to make remarks at the Int'l Assoc. of Firefighters."

Twitter really caught fire, though, at the South by Southwest music and digital conference, held Mar. 9-18 in Austin, Tex. Obvious cleverly prepared the ground, setting up two 51-inch plasma screens next to the conference registration desk and in a hallway where panels let out. As the techie crowd milled around, they



"It's creepy to me. Why does someone need to know I am putting on my socks?"

—Dave Cote, marketing consultant and blogger

began paying attention to the scrolling updates from bloggers about hot parties, panels, and restaurants. "You would go into a panel room and 20% of the people would be staring at their phones, sending out or getting updates," says Narendra Rocherolle, an early Twitter user.

Twitter taps into a basic need of many Web users: to suck up every last crumb of personalized information, instantly. Steve Rubel, a public-relations exec who can't seem to stop blogging about Twitter despite protests from some of his readers, points to how Twitter was his first source

of news for I. Lewis "Scooter" Libby conviction. Other Twitter fans boast that they beat the U.S. Geological Survey in relaying news about a recent moderate earthquake in San Francisco. For some, Twitter reflects the increasing power of word-of-mouth networks to change how news is made and defined and how market information is distributed.

But in pointing to a world where the noise of the social crowd is amped up exponentially, Twitter forces into the open a basic schism—between those who want to know what everyone is doing all the time and those who are revolted at the idea of giving up that information or caring about anyone else's. "We're hitting a world where we're constantly connected," says Dave Cote, a marketing consultant who wrote a blog post entitled Twitter is for Twits. "It's creepy to me. Why does someone need to know I am putting on my socks?" he asks.

In a recent blog post, *Real Twitter* (2007-2007), Mathieu Balez, a Web entrepreneur, knocked the mundane nature of Twitter posts ("Going to the gym," "Groceries with mother-in-law") and the voyeurism of readers. Twitter will be history by the yearend, abandoned by former fans too tired to keep up with endless streams of quotidian tidbits, he predicted. Balez's blog was soon flooded with comments, pro and con. "Yes, sure," one Twitter supporter replied. "Twitter will die. Just as text messages, mobile phones, blogs, the Internet..."

Of course, there's another possibility: that Twitter will begin to provide services that have more obvious value. In different contexts, say among friends or colleagues, knowing that someone is sick at lunch explains why they aren't returning your call or why they're so cranky, argues Ross Mayfield, chief executive of corporate wiki outfit Socialtext Inc.

For that to happen, the information or time required to enter it—can't be overwhelming. And Twitter must refine its filters. Right now it's possible to direct updates to one person, but imagine if you could selectively reach certain groups of colleagues and filter recipients according to subjects, like restaurants. Already Twitter tools are popping up, such as maps that show where people are tweeting and a Twitter search engine.

Twitter may or may not survive this year. But the idea behind it could live on—and result in the sort of message you truly do want to hear. ■



The health care system isn't healthy. There's no denying it. A system that was designed to make you feel better often just makes things worse. Costs are out of control, access is inconsistent, quality is too variable and the entire process has become unwieldy.

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COMPUTERS

GRUDGE MATCH IN CHINA

HP and Dell are exporting their rivalry —and starting to challenge Lenovo

BY BRUCE EINHORN

USED TO BE, PLACES such as Shanghai's Atlantic Ocean electronics mall didn't offer much variety. Stores stocked computers from a handful of local companies or no-name boxes snapped together by technicians, and foreign brands were tough to find. But these days the foreigners are making inroads, and none more aggressively than Hewlett-Packard Co. Enter the four-story mall and you immediately see a Hewlett-Packard shop festooned with bright red-and-yellow paper Chinese lanterns, one of three outlets the company has on the first floor alone.

Shopping centers like this one are becoming a key battleground in the global PC war. While native son Lenovo Group still dominates the market with a 36% share, HP and Dell Inc. are gaining ground. HP moved into the No. 3 position in the fourth quarter of 2006. Today it has more than 9% of the market and is within striking distance of No. 2, Beijing's Founder Technology Group Corp., which has 13%. Dell is No. 4, with just under 9%, up from 7% at the end of 2003. "Everybody wants a piece of China," says Stephen J. Felice, Dell's chief in the region.

It's easy to see why the Americans are taking their stateside rivalry to China. In 2006, PC sales in the U.S. advanced just 2.6%, according to market tracker International Data Corp. But in China they jumped 21%, to 23 million. At this rate,

China will overtake the U.S. as the biggest computer market by 2013, according to New York tech consultancy Wolf Insights. Although neither HP nor Dell breaks out China sales, American Technology Research, a securities firm in San Francisco, estimates that they account for less than 2% of companies' global revenues. Still, PC makers can't afford to neglect the \$19 billion market. "China is among the fastest-growing economies in the world, and PC penetration is low," says Shaw Wu, an analyst with the firm. "It is critical for any player to do well there."

The Americans are working hard to improve their game. Chief Executive Officer Michael Dell traveled to Shanghai on Mar. 21 to launch a new computer designed for China. The \$340 Dell EC280 uses only about a quarter of the power of a conventional desktop and has been simplified for first-time computer buyers. "We said to ourselves: 'Let's design something that doesn't have things that



people don't use," says Darrel Wu, Shanghai-based director of the research and development team that designed the computer. "Those things cost money and add complexity."

NEW ROAD MAP

HP, MEANWHILE, has spent the three years remapping its main operations. The company has an lab in Shanghai and a research center in Beijing that focuses on long-term projects. HP has also been boosting number of outlets selling its products. By yearend the store tally will reach

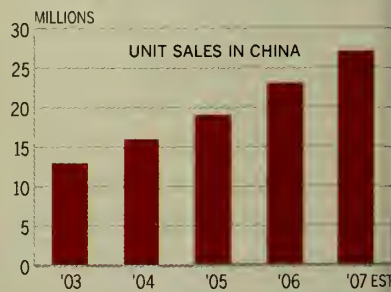
TURF BATTLE

HP and Dell are gaining...



*LENOVO'S 2003 SHARE EXCLUDES IBM'S PC DIVISION

...as PC sales zoom



Data: IDC, Lenovo



PEDALING DELL The company is launching a model for first-time buyers

state-backed company's market share is growing as the "white-box" segment, today roughly one-quarter of the market, continues to shrink, and it picked up five points from its 2005 acquisition of IBM's PC division. Yet Lenovo is struggling in its quest to become a global powerhouse, as many former IBM users overseas are reluctant to embrace the new Chinese owners. And at home, Lenovo's profit margin is slipping. It's down to 5.1% in the most recent quarter, vs. 6.5% at the start of 2006, largely because of price cuts designed to keep the foreigners at bay. Despite its troubles, Chen Shaopeng, Lenovo's president for Greater China, dismisses suggestions that its home advantage may be eroding. "No one else has such a strong portfolio," he says.

Nor do they have Lenovo's reach. The company already sells its PCs at more than 12,000 outlets nationwide, and plans to add 1,000 more this year. "This is our competitive edge," says Chen. It's also pushing deeper into the Chinese countryside with a \$650 PC targeted at farmers and a campaign to promote computer use in rural areas. Under CEO William J. Amelio, a former Asia hand at Dell, the company has been

trying to bolster management ranks by poaching talent from rivals, including several Dell executives and, in March, HP's China brand director, Arthur Wei.

For both American players, the biggest challenge in China is reaching customers. In the U.S., Japan, and Europe, computer users tend to be concentrated in big metropolitan areas, but about half of potential PC buyers in China live in small towns and cities. "You need to have your people going to 3,000 cities and establishing relationships," says Roger L. Kay, president of Endpoint Technologies Associates Inc., a consulting company in Wayland, Mass. "It's just a very big job."

—With Olga Kharif in Portland, Ore., and Dexter Roberts in Beijing

At current rates, China will outrun the U.S. in PC sales by 2013

000, compared with 330 in 2003. And to spice up its marketing, the company is staging promotional shows featuring back-clad models and elaborate laser displays. "It needs to be fun and fashionable," says Ding Hui, HP's Beijing-based marketing manager.

Indeed, as Chinese buyers face a wider array of brand choices, style is coming a bigger consideration. Xu Jun, a 26-year-old IT technician, owns three no-name machines he assembled himself. But when he decided to splurge on a fourth computer last year, he didn't even consider a Lenovo. "The look is not very good," he says. Instead, he went for a \$750 HP notebook with a 14-inch per-bright screen and scratchproof case. "This one is more fashionable," Xu says on a visit to an HP customer center in Shanghai, one of dozens the company has opened around the country.

Savvy customers such as Xu are far less common in smaller Chinese cities, where PC penetration lags far behind the national average of 7%. That presents a special challenge to Dell, since it depends on customers understanding computers already. So far, most of its China business has been with corporate accounts, but now Dell is tinkering

with its direct-sales model to better reach consumers. Last year it opened three "customer-experience centers" (as they are called in Dell-speak) in Nanjing and Chongqing where would-be buyers can test-drive PCs and get help from Dell salespeople in ordering. "The strategy is to use the centers to reach out to consumers who really want to have the touch and feel of our products," says Alex Yung, North Asia sales director for Dell.

Dell, too, is boosting its research in China. A five-year-old R&D center in Shanghai now employs some 500 people, up from 300 a year ago. Those engineers developed Dell's new low-cost China PC and will now work on adapting it for Brazil, India, and other emerging markets. Striding past a sea of cubicles, the center's managing director, John Terwilliger, points to a wall covered with blue-and-white Dell banners awarded in recognition of the center's work. "There are more coming," he predicts.

The burst of foreign competition is increasing the pressure on Lenovo. The

OUTSOURCING

BLUEPRINT FROM INDIA

More architecture firms are offshoring

BY PETE ENGARDIO

EVEN IN LAS VEGAS, A CITY not known for understatement, the overhaul of the Tropicana Casino & Resort is grandiose. When the \$2 billion face-lift is completed in 2010, the hotel will have more than 10,200 rooms, a new convention center and shopping mall, parking for 6,200 cars, and multiple pools. That's great for gamblers, but it's a big challenge for the architects putting all the pieces together. "It's like building three mega-resorts at once," says Jim Stapleton, vice-president of Cincinnati-based FRCH Design Worldwide, the lead architect on the project. Adding to the complexity, gaming tables and sections of the hotel will remain open through the renovation. Worse, it's happening at a time when U.S. architects are in short supply.

Time to call India. In a cramped office in Kolkata, some 8,000 miles from the Strip, dozens of Indian architects spend their days and often nights generating plans for the Tropicana. They work for Cadforce Inc., a Marina del Rey (Calif.) startup that is helping bring offshore outsourcing to yet another U.S. sector. All told, Cadforce has some 150 designers and computer technicians in India and 41 in the U.S. working on a new hospital in San Diego, private homes, fast-food joints, and more. "The tidal wave of interest has just begun in the last year," says Cadforce CEO Robert W. Vanech, a venture capitalist who founded the company in 2001.

One California firm found outsourcing helped it cut fees by 30%

Cadforce is one of a growing number of companies jumping into the business. The \$29 billion U.S. architecture industry ships about \$100 million in work abroad each year, Cadforce estimates. Some 20% of U.S. firms say they are offshoring, according to a survey by Harvard University and the American Institute of Architects (AIA), while an additional 30% are considering doing so. "Clients are demanding shorter and shorter turnarounds, smaller fees, and better details," says Harvard doctoral student David del Villar, who helped lead the study.

While the work isn't glamorous, many Indian architects say it's a great opportunity. Rather than developing complete designs, architects in these outsourcing shops tend to handle tasks such as turning schematic drawings into blueprints or making sure doors and pipes are aligned. These are essential jobs, but they're tedious and can take up 60% of the time spent designing a building. Nonetheless, 25-year-old Adinti Sengupta jumped at the opportunity to join Cadforce. "It's a chance to work with more space and nicer materials," she says.

Digitization is one big force driving the trend. More architectural firms are adopting sophisticated computer tools that allow them to render entire buildings in 3D, simulate stress tests, and track all construction materials. That makes it

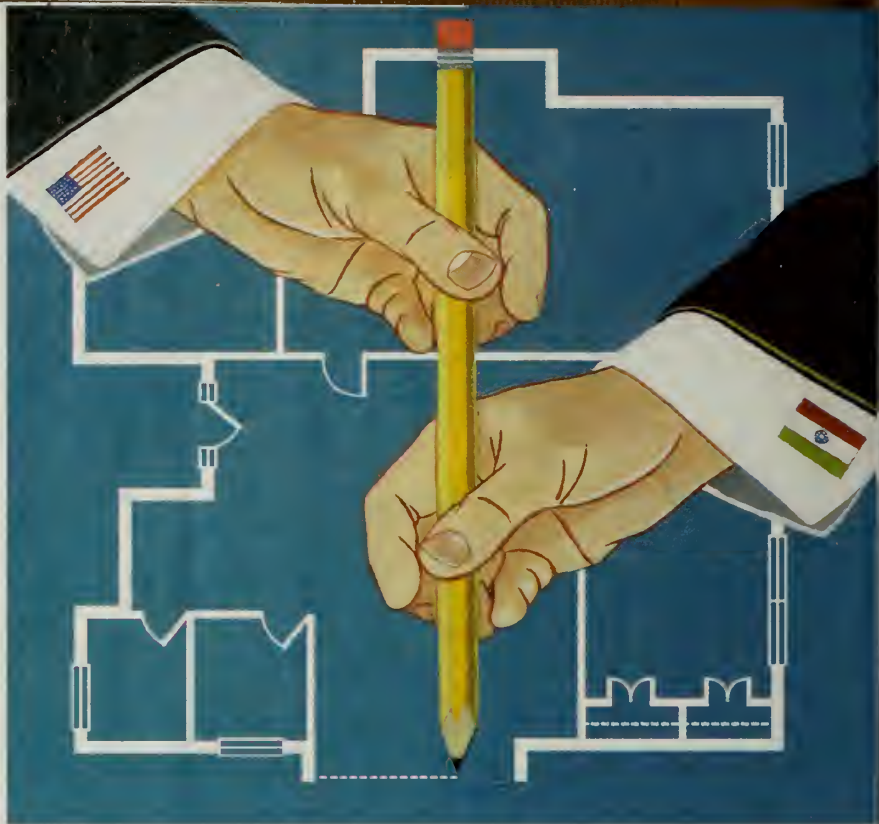
easier to work remotely—and require tech skills that can be hard to find in the U.S. "The challenge isn't cost. It's understanding the processes and systems," says Michael Jansen, CEO of Satellier, New Delhi-based group with 300 staffers doing work for half of the top 30 U.S. architecture firms.

JUST FOR NOW?

NOT EVERYONE is convinced the future of architecture lies offshore. AIA Chief Economist Kermit Baker thinks the outsourcing surge is largely the result of cyclical talent crunch. He notes that the pay gap between U.S. and Indian architects isn't nearly as wide as in, say, software programming. Many American architects with 10 or 15 years of experience earn up to \$60,000 annually—about four times what Indians take home. That compares with salary differentials of 8 to 10 times in software. "If the job market softens, there will be a lot less incentive to outsource," Baker predicts.

Still, many firms say outsourcing pays. Acres Group Inc., a firm in Pasadena, Calif., that specializes in fast-food restaurants, has been able to take on 75% more work by outsourcing some tasks to Cadforce. While Acres is saving money, President Robert Liu says he has been able to lower his fees by 30%—other factors are more important. "They do the most time-consuming, technical work," Liu says. "It allows me to do other things, like get more clients and concentrate on design." ■

—With Nandini Lakshman in Kolkata



MERGERS

THE SMART MONEY IS CHASING EURO DEALS

Investors from both sides of the pond are on an "Easter egg hunt" for potential plays

BY CAROL MATLACK

ITS NAME MAY SOUND SOFT AND comforting. But the Children's Investment Fund, a London-based hedge fund better known as TCI, is more like a pebble in the shoe of Europe Inc. Just ask ABN Amro.

Under assault from dissident shareholders led by TCI, the Dutch bank confirmed on Mar. 20 that it is in talks to join Barclays PLC in a potential \$80 billion deal that would be Europe's biggest-ever cross-border banking merger; ABN Amro had been seeking a suitor to fend off TCI, which owns about 10% of the bank's stock.

The episode underscores the growing boldness of hedge funds and other activist shareholders in corporate Europe. They're buying stakes in some of the Continent's biggest blue chips—from banks and retailers to consumer giants such as Cadbury Schweppes PLC—and then pushing the companies to streamline operations and shed underperforming assets. "Europe is like an Easter egg hunt"

for this crowd, says Chris Young, a researcher at U.S.-based Institutional Shareholder Services Inc.

Why now, when value-hungry investors have been sniffing around the Old World for years? One reason is that while aggressive players such as TCI provide the spark, their efforts are now being fueled by institutional investors. Two major Dutch pension funds, for instance, endorsed TCI's calls for a breakup of ABN Amro. And big shareholders in Deutsche Börse, including funds run by Fidelity Investments and Merrill Lynch & Co., allied with TCI

and New York hedge fund Atticus Capital to block the Frankfurt market's attempted merger with the London Stock Exchange in 2005. In both cases, the hedge funds' arguments were amplified by the support of money managers with big stakes in the companies.

Now, some mainstream European funds are taking the lead in shareholder fights. German travel agency TUI on Mar. 19 said it will merge with Britain's First Choice Holidays PLC and then list

Plenty of the pebbles in corporate Europe's shoes come from across the Atlantic. Colony recently joined luxury magnate Bernard Arnault in taking a 9.8% stake in French retailer Carrefour. Together, they are pressing for a sell-off of some of its real estate assets. U.S. hedge fund Trian, headed by veteran raider Nelson Peltz, spurred drinks-and-candy giant Cadbury Schweppes to cut itself in two after taking a 3% stake in the company recently. And last year a shareholder revolt led by New York-based Knight Vinke Asset Management triggered the \$9.6 billion sale of Dutch group VNU to a group of private-equity investors including Kohlberg Kravis Roberts and the Carlyle Group.

Unlike the U.S., where most big companies long ago yielded to restructuring demands, the Continent still has plenty of tempting targets. Consumer giant Unilever, for instance, has been mooted as takeover bait because it is less streamlined than American rival Procter & Gamble Co. and has resisted shareholder pressure to split the company. ABN Amro is in similar straits. Its stock has stagnated for seven years as it lagged rivals in cutting costs and

In Play Activist funds are shaking up Europe's blue chips

ABN AMRO

Pressure from hedge fund TCI may force it to merge with Barclays in Europe's biggest-ever cross-border banking deal



CARREFOUR

U.S. investment group Colony Capital is pushing the world's No. 2 retailer to sell off real estate holdings

CADBURY SCHWEPES

New York-based hedge fund Trian spurred the food and beverage giant to split into two companies



in London, a move prompted by activist shareholders including Hermes, the pension fund manager for BT Group PLC, and DWS, Deutsche Bank's money-management arm. In a parallel to the ABN Amro drama, TUI agreed to forge the link in response to dissident shareholders who wanted to break the company up. More and more, "investors are willing to vote with their money and put some muscle behind those decisions," says Thomas J. Barrack Jr., who heads California-based real estate fund Colony Capital.

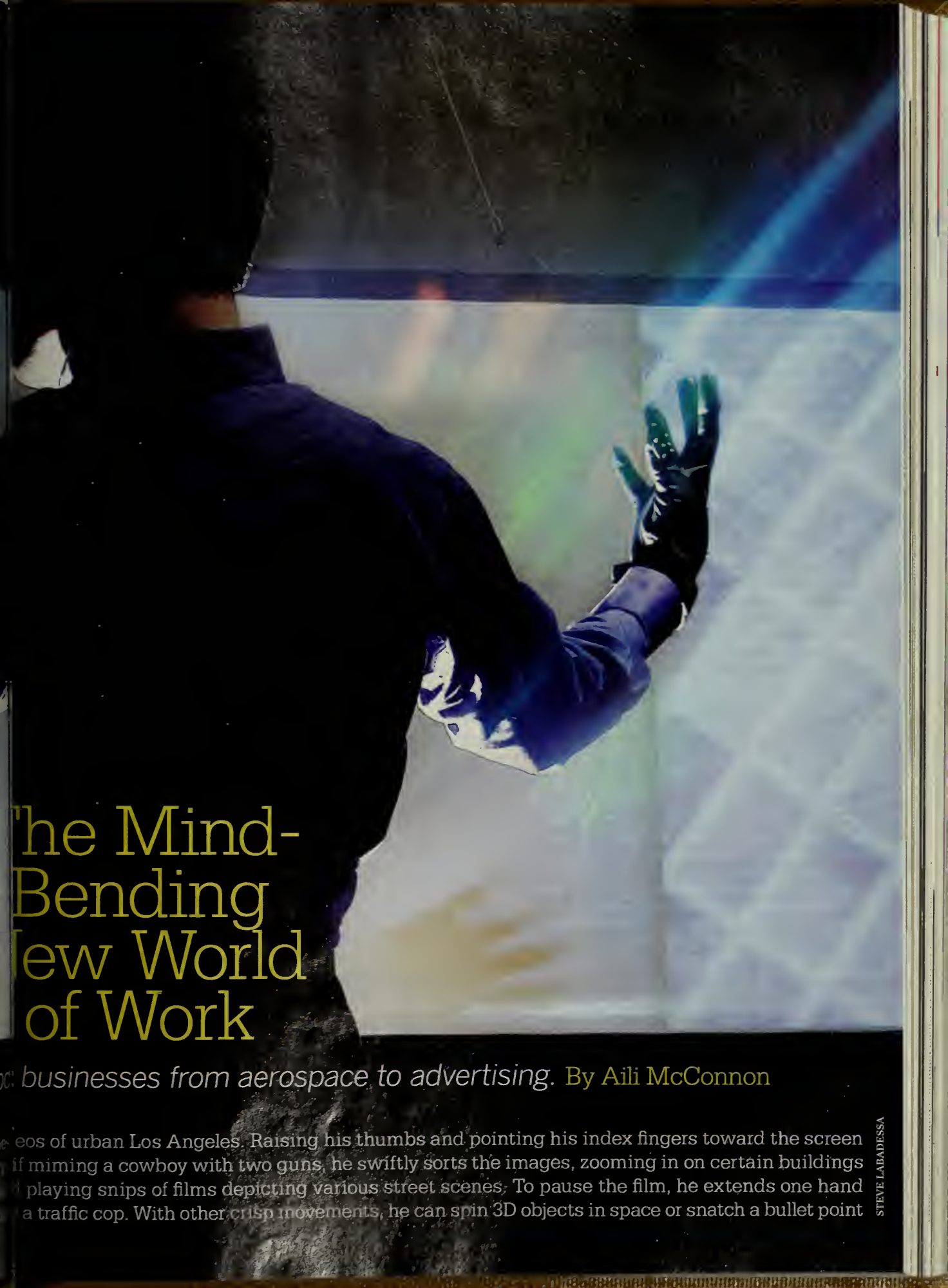
focusing its business. Enter TCI (the "children" in the name refers to a charity run by founder Christopher Hohn's wife that gets a share of management fees). The press-shy Hohn issued a statement saying TCI was "encouraged" by news of ABN Amro's talks with Barclays, which produced a healthy 10% bounce in the Dutch bank's share price. But TCI warned that the talks should not preclude other bids "to produce the best results for shareholders." Little comfort there. ■

—With Jack Ewing in Frankfurt and Kerry Capell in London



Motion-capture technology has burst out of Hollywood

In a darkened loft in the industrial district of downtown Los Angeles, Games Studios CEO Kevin Parent slips on a pair of black gloves studded with iridescent white, purple, and yellow dots. Standing about 10 feet from a wall-screen, he lifts his hands like a conductor. With a series of precise gestures, he calls up photos



The Mind-Bending New World of Work

businesses from aerospace to advertising. By Aili McConnon

...eos of urban Los Angeles. Raising his thumbs and pointing his index fingers toward the screen
...if miming a cowboy with two guns, he swiftly sorts the images, zooming in on certain buildings
...playing snips of films depicting various street scenes. To pause the film, he extends one hand
...a traffic cop. With other, crisp movements, he can spin 3D objects in space or snatch a bullet point

of text and drag it across the screen. "You just put on the gloves and go," Parent explains. "Think turbo PowerPoint."

The technology preview Parent arranged for *BusinessWeek* bears an eerie resemblance to a famous scene in *Minority Report*, Steven Spielberg's 2002 film featuring Tom Cruise as a cop under investigation for murder. Techies still talk about the wireless data gloves and clipped hand signals Cruise uses to sort through evidence on a giant screen at police headquarters. That interface is just what Gesture is selling to companies that create presentations at the 14,000 trade shows and conferences in the U.S. each year. The hardware and software will be priced from a few thousand dollars and up. Soon, anyone making a PowerPoint presentation to colleagues or business partners could operate the same setup, which uses cameras to track hand movements and translate them into computer instructions. The similarities to *Minority Report* are no coincidence: Gesture Studios is the brainchild of Massachusetts Institute of Technology wunderkind John UnderKoffler, who helped Spielberg's production team design the scene in the movie.

Goodbye to the Remote

GESTURE'S SYSTEM, KNOWN AS GoodPoint, showcases a technology called motion capture, which film studios and video game makers have used for years to make computer-animated characters appear more realistic. Now motion capture is bursting out of Hollywood and changing the way consumers interact with home electronics. Motion sensing is the secret ingredient in Nintendo's wildly successful Wii game system, which lets you swing a wand in your living room to hit a home run in an animated ballpark on your TV set. Intel Corp. is developing a more advanced version of motion capture that will let people wave at their TV sets from across the room to turn up the volume or change channels—no gloves or sensor dots required. Within five years "you could use gesture recognition to get rid of the remote control," predicts Intel Chief Technology Officer Justin Rattner. "We've done prototypes of that, as have other people." Rattner says body tracking—the whole body, not just the hands—could drive demand for its important new generation of semiconductors, the superprocessors known as teraflop

chips, which Intel previewed in February.

Motion capture is starting to transform how businesses market their products as well as design and manufacture them. This spring the Las Vegas McCarran International Airport will set up large

COST-CUTTER

» Using its motion lab allowed Lockheed Martin to save \$50 million on one task alone

plasma screens with a motion-tracking component that lets advertisers bring pedestrians into their commercials. When you walk past a car ad, for example, the vehicle might move at the same speed you're walking. When you turn

to look at the driver, he'll turn to look at you, and you'll be staring into an image of your own face. Dozens of blue-chip aerospace, auto, and heavy-equipment makers, from Lockheed Martin to BMW to Caterpillar already use motion tracking to let workers collaborate in shared virtual environments, sometimes when they are thousands of miles apart. Together they can test the ergonomics of a design for a car or a plane. "Any company that creates a product used by people needs to understand how the human body moves," says Lek van Cruyningen, head of securities at Libertas Capital Group, a specialist investment bank. "Motion-tracking systems and virtual simulations accelerate product development and boost productivity."

Motion capture marks a new stage in a revolution heralded back in the 1980s. That's when computer geeks first started talking about an immersive digital domain called virtual reality (VR). You may remember the first dorky VR goggles users donned to experience virtual worlds, the unabashed pronouncements about world-changing, computer-generated realms, and camp media depictions such as the 1982 Walt Disney movie *Tron*. Some well-funded academic laboratories went ahead and developed these goggle-and-glove environments. But as a consumer application, virtual reality 1.0 was a bust. The hype was too loud, computers were too slow, networking was too complicated, and because of motion-sickness issues that were never quite resolved, the whole VR experience was, frankly, somewhat nauseating.

It was a classic tale of high-tech crash and burn. The technology arrived prema-

Bringing Your Body Into a Virtual World

MOTION CAPTURE 101

Motion-tracking systems use a combination of computer chips, sensors, and cameras to record humans in motion and create digital doppelgängers that move the same way. Here's how two different companies do it:

» **NINTENDO** The Wii game system uses a wand studded with motion-sensing chips. When you swing the wand, a sensor bar on



game console attached to TV recognizes the movement and transmits it to your avatar on the screen. The better you swing, the better it is for your avatar to hit a home run.

» **DISNEY** For *Pirates of the Caribbean: Dead Man's Chest*, the special-effects crew covered actor Bill Nighy from head to toe with reflective motion markers. Cameras captured his every move and facial expression, then mapped all of it onto his digital double. No elaborate costumes, no prosthetics. (Nighy's outfit and accoutrements were rendered digitally afterward.) When Nighy leers, pre-so does Davy Jones. *Pirates* won a 2006 Visual Effects Oscar.





MOTION CAPTURE 201

Most major aerospace and car companies use motion-tracking systems to immerse engineers, designers, and customers in virtual planes and cars long before a prototype exists. Here's how the technology helped Lockheed Martin design the F-35 stealth fighter:

1 At Lockheed's Ship Air Integration Lab, as many as four designers, engineers, and customers don body suits and caps with reflective sensors. They enter a 15-by-20-ft. space where 24 cameras track the motion of their hands, heads, and bodies.



2 Through their head-mounted displays they see digital renderings of each other and the jet's 3D prototype. Here they practice a crucial task that will be repeated thousands of times once the plane is built. They're checking a wheel that is attached to a catapult on the ship, which is used—like a slingshot—to launch a plane from the ship's deck. If they can't easily perform the task in the virtual-reality space, they tweak the design.



3 On a nearby screen, advisers—typically a mix of active-duty and retired U.S. Navy, Marine, and Air Force senior officers—observe what's going on virtually and weigh in based on their real-world experience. Such simulations reduce the number of expensive prototypes needed to create and test new planes.



turely, dragged investors through bitter disappointment, and lost startups and their backers buckets of cash without ever yielding a return. VR 2.0, enhanced by motion capture, is different in many critical ways. Most important, the first batch of applications, such as the Wii, while still primitive, are easy to use, inexpensive, and hard to crash. You don't get anything close to a fully sense-surround experience, but neither do you feel sick after you put down the wand. The games are simple and intuitive, which is why a new stereotype has emerged in the game market: Wii-toting grandmas and grandpas.

Pioneers in VR 2.0 are likely to piggyback on Nintendo's strategy: Wow the audience with fairly simple ways to bring their bodies into the action. Gesture Studios' GoodPoint system enables a presenter to take audiences on a tour of a 3D architectural design or on a fly-through of a model city. And the presenter's measured theatrics make a big impression.

"Everyone's looking for the new, sexy way to communicate with their employees and their clients. We're selling their ability to sell," says Tom Wiley, Gesture's director of business development and operations. Future versions of GoodPoint will help air-traffic controllers visualize complex flight configurations and let security personnel sift quickly through hours of video using hand gestures alone. There's even a diminutive glove or thimble version for use with a PC, which could end the decades-long tyranny of the keyboard and mouse.

Swirling Snowflakes

THE ADVERTISING INDUSTRY IS dreaming up uses for motion capture that literally stop consumers in their tracks. Recently, with little fanfare, Target, adidas Group, and Clorox began running interactive ads on subway station walls in New York. One Target ad, a 6-by-20-ft. projection, featured snowflakes gently fluttering from the sky. It seemed unremarkable until you approached the wall. If you swiped your hand in the air, the background scene transformed from a wooded winter scene into a city skyline. And by waving both hands you could send the snowflakes into a swirl.

Adidas chose a similar approach for its ad in the entrance of the Mandalay Bay Resort & Casino in Las Vegas. The ad perked up when people walked by and responded with a shower of shoes. The more they gesticulated, the bigger

the deluge became. "People don't ignore the ads—they want to play with them," says John Payne, president of Monster Media, which created the campaigns for adidas, Clorox, and Target. "It's like Willy Wonka."

Avatar Engineers

LOCKHEED MARTIN, THE WORLD'S largest defense contractor, has pushed motion sensing to even more exotic extremes in an effort to reduce design and manufacturing costs. The VR effort at its Ship Air Integration Lab in Fort Worth is headed by Pascale Rondot, a petite French Canadian who worked in a similar program at General Electric Co. Her lab is helping to develop new F-35 stealth fighter jets that can take off on land or at sea. Lockheed won a contract in 2001, now valued at \$25.7 billion, and the first of the fleet of nearly 4,000 planes will be completed by 2010—part of a program valued at roughly \$276 billion.

To help engineers, technicians, pilots, and Lockheed customers understand how the plane will perform, Rondot equips teams of visitors—up to four at a time—with VR headsets and suits dotted with motion-capture sensors. They enter a darkened 15-by-20-ft. area where 24 cameras track their every move. What the visitors "see" through their head displays are the fighter prototype and lifelike avatars of one another. They can walk through the prototype, crouch down to inspect or change a part, and practice physical routines they will replicate in real-world planes many months later. Nearby, in a separate area called the cave, Lockheed invites active-duty and retired Navy, Marine, and Air Force senior officers who can view both the people and the virtual aircraft in the simulation.

Aeronautics veterans who hear about this program are sometimes skeptical.



Moving Smarter to Avoid Injury

» The National Pitching Assn. in San Diego uses a motion-capture system to help baseball players improve their game, avoid injuries, and extend their pitching careers by analyzing the biomechanical efficiency of their moves with far greater precision than the human eye.

"When people cannot touch a prototype, it's always a hard sell. But then they see how our virtual world matches the real world and how much time and money we've saved," says Rondot with a Quebecois lilt. For one task—examining the approach speed of the plane as it lands—Lockheed was able to save \$50 million in design changes and avoid 50% of the cost of the mockup by using the VR lab instead of traditional wind-tunnel tests. In a simulation, Rondot can bring Lockheed engineers together with far-flung counterparts at partner companies such as GE and Pratt & Whitney.

With profits of \$2.5 billion on \$39.6 billion in revenues, Lockheed can afford to splurge on motion capture. But even companies with much tighter budgets

are drawn to the technology. At Ford Motor Co. headquarters in Dearborn, Mich., engineers use motion tracking and simulation in both product design and manufacturing to reduce dependence on expensive metal prototypes. Manufacturing ergonomics expert Allison Stephens creates digital versions of Ford factories then analyzes the reach and posture of people on the assembly lines to reduce the risk of injury. At one pilot plant, such simulations have reduced the expected number of disability cases by 80%, says Stephens. Disability payments can run tens of millions of dollars a year.

As users rack up successes, suppliers of motion-capture systems for factories could be in a sweet spot. "It's early, but such simulations could be one of the

for the record



most profitable areas in the future," says Kathleen Maher, an analyst at Jon Peddie Associates Research who has written reports about the auto industry's use of modeling software. Maher pegged the size of the market of "augmented reality"—simulations with some props—at \$142 million in 2006 and says it is growing quickly. Manufacturers may be the power users of VR 2.0, but Hollywood studios will continue to be the biggest patrons and innovators. Director James Cameron says the technology first had a huge impact on film in his *Titanic*, the highest-grossing movie of all time, which brought in upwards of \$1.8 billion. Only a small number of actors in motion-capture suits were required to create the famous crowd scenes on the decks of the

sinking ship. Digital data were collected and then duplicated to recreate the scene of the disaster.

The technology then spawned a slew of computer-generated creatures, including Gollum, the gurgling, wispy-haired ring thief in Peter Jackson's *Lord of the Rings* trilogy, and *King Kong*, by the same director. British actor Andy Serkis spent hours scampering around on set in sensor-studded suits to create Gollum's scuttling and Kong's signature grimaces. For such scenes in the past, animators might draw each new movement by hand, frame by frame. And that's not the only giant expense motion capture could address. During a movie shoot, "the cost of a day on set can range from \$50,000 to \$1 million," says Gary Roberts, a vice-president at House of Moves Inc., the Los Angeles motion-capture lab that did Robert Zemeckis' *The Polar Express*. "Motion capture shaves days off the overall production time." And the process could get even simpler. In Cameron's current film project, titled *Avatar*, sophisticated software may eliminate the need for sensor dots on actors' faces. Instead, one tiny camera on an actor's head cap tracks and interprets every twitch.

Companies that come up with such innovations stand to make small fortunes. "There is an arms race in entertainment," says Phil Sparks, an analyst at Evolution Securities Ltd. He's bullish on Vicon, part of Oxford Metrics Group, the largest company making motion-capture systems for entertainment and now many other clients. "They're no longer just mapping out an orc and a hobbit having a fight. They're now doing the expressions on dozens of actors' faces." Motion Analysis Corp., another motion-

tracking player, built systems that were used for *Kong* and one of the *Rings* films and also outfitted Lockheed's lab.

Capturing actors' movements is potent stuff, says Cameron: "The technique frees performers from the limitations of body type, age, race, and gender. The essence of their spirit as actors can be infused into any physicality they or the filmmakers dream up." For example, you could tell a story that follows the same character from childhood to old age and have the same actor play the character at every stage—without makeup. Video game makers are also channeling mounds of money into motion capture. Tiger Woods donned a sensor suit to make his video game doppelgänger look more realistic.

What the Wii Wrought

THERE IS ALWAYS THE RISK THAT the buzz about an emerging technology will get ahead of reality. Jackie Fenn at market research firm Garner Inc. charts such "hype cycles" and notes that virtual reality has spent many years mired in something she calls the "trough of disillusionment." But PDAs and MP3 players also languished in this stage, she says, until the "beautifully designed interfaces" of the Palm Pilot and the iPod and services such as iTunes launched these devices into much wider public acceptance.

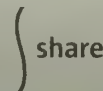
It's possible that Nintendo's Wii could do the same for gesture recognition. Four months after this revolutionary system arrived in the U.S., it is still trouncing the competition, according to market researcher NPD Group Inc. And it is cropping up in communities that never appreciat-

BEYOND CADAVERS

» At Stanford, surgical residents learn to cut, suture, and cauterize virtual organs

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ed video games. One retirement home near Chicago has started a Wii bowling league, and game experts expect to see more such developments. Software giant Electronic Arts Inc. is rolling out golf and war games for the Wii, as well as a title based on *The Godfather* films. EA believes motion sensing will become standard in game controllers. "The Wii is helping debug this question about how you move in virtual ways," says Jaron Lanier, a scholar at the Center for Entrepreneurship & Technology at the University of California at Berkeley who is credited with coining the term "virtual reality." After a year with the Wii, society "will be better educated about the overlap of the virtual and the real world," he says.

The semiconductor market is responding to Nintendo's huge success. Demand for the special sensing chips used in the Wii will double, to \$10 billion, by 2010, according to industry researcher Yole Development. Such chips, produced by the likes of Intel and STMicroelectronics, will be used in all kinds of industrial applications, not just home systems. But Intel expects to play an important role in promoting

motion technology in the entertainment arena. And just as its processors helped fuel the PC revolution, Intel's next-generation chips and software could lower costs and jump-start a mass market for VR 2.0. The company is seeding such ideas in its community of application developers and even placing some of its own software in the public domain.

Reading Your Mood

ONE FRONTIER LIES IN TRACKING facial expressions without costly and cumbersome equipment. Advertisers, for example, would like to have the ability to read the changing expressions on their customers' faces as they browse Web sites—or shop at the corner store. In August, 2006, Google Inc. acquired a small company called Neven Vision for an estimated \$40 million. The startup has several patents on algorithms for tracking movements of key points on the face—the corner of the eye, the curves of the mouth—using a webcam, a mobile phone, or security cameras in bank machines and convenience stores. Google

Improved Design Without Prototypes

» At Bell Helicopter's Simulation Center in Fort Worth, an engineer is evaluating the merits of a new canopy for a helicopter cockpit. In the simulation, she contrasts the new design with an existing canopy to decide what features need to be changed. The center uses cameras and some software originally created for the entertainment industry. Bell makes both commercial and military helicopters.

hasn't yet announced plans to create products based on these patents. But researchers at Stanford University have already come up with systems that can read such signs to tell whether a person is interested, happy, or annoyed. And they can even map those responses onto the face of an avatar in a virtual world.

In certain areas of medicine, motion technology can improve treatment quality. Howard J. Hillstrom, director of the Motion Analysis Laboratory at the Hospital for Special Surgery in New York, has used motion tracking to help people w

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ADVERTISING

Monster Media creates motion-sensitive ads for adidas, Target, and others. Projected on walls and floors, the ads respond to the gestures of passersby. More advanced systems bring the faces and

bodies of nearby pedestrians into the ads on flat screens.

Payoff: People play with ads instead of ignoring them.



HEALTH CARE

The Hospital for Special Surgery in New York and other medical centers have a system that tracks patients' movements and matches them against a model of how healthy people move. **Payoff:** Arthritis,

cerebral palsy, Parkinson's, and other diseases are easier to evaluate and treat effectively.



MARKET RESEARCH

Microsoft, Yahoo!, and eBay have purchased eye-tracking screens from Tobii Technology. **Payoff:** When customers browse a Web site, a store shelf, or a TV ad, smart systems tell companies exactly

where customers are looking and for how long.



AUTO SAFETY

Siemens is developing a "drowsiness detection" system that uses a camera in the dashboard to monitor drivers' faces. If they appear drowsy or inattentive, an alarm sounds or the steering wheel shakes.

Toyota and Nissan are sponsoring similar research at Stanford University. **Payoff:** Fewer traffic accidents.



MOBILE PHONES

Most Verizon phones can use movement recognition software from GestureTek. Users download the program and then tilt, shake, or flick their phones to play games such as moving a marble through a maze.

Payoff: Consumers don't jam their thumbs on small keys while playing games.



SECURITY

The Defense Dept. is sponsoring research at New York University into "gait recognition" software that runs on low-cost security cameras. **Payoff:** A known terrorist may change his hairstyle or facial

features, but he can't hide his distinctive stride.

disorders from cerebral palsy to arthritis. As patients fitted with sensors walk in front of cameras, Hillstrom's computer screen displays a skeleton in a 3D grid, and software helps the doctor analyze whether the patient is moving properly. "The number of baby boomers with arthritis will pass 60 million by 2020. Their movement is often the first thing to deteriorate," he says.

Tracking the surgical tools of several doctors in different locations can allow them to occupy the same simulation. "A surgeon could teach a resident in a remote village thousands of miles away, showing them how and where to move their hands," says Dr. Parvati Dev of Stanford University's Summit Lab, where residents learn to suture, cut, and cauterize virtual organs. Lately, doctors have

also incorporated a technology called haptics—"force feedback" built directly into the surgical tools. When a surgeon probes or tugs on a gall bladder or some other tissue, he or she senses resistance (imagine pushing or pulling a spring). Dr. Dev's lab has done studies showing that residents trained on such simulations have a much shorter learning curve when they get into the operating room.

Tracking faces can save lives as well. Toyota, Nissan, and others have sponsored research at Stanford investigating the expressions drivers typically have five seconds before they fall asleep. These can be detected with simple cameras installed in a steering wheel or dashboard that trigger an alarm. Jeremy Bailenson and Cliff Nass, who are leading the research, say such cameras

are now in cars coming off production lines in Japan. Siemens is developing similar "drowsiness detection" devices.

Demand for systems that watch the world in motion could be broad and compelling. At the Intel Developer Forum in Beijing in April, the chipmaker will preview something called sports summarization that is designed to make good use of Intel's superchips. Outfitted with such processors, your television could speed highlights such as a soccer goal, penalty kick, or any signature motion you desire. Then, instead of relying on the newscaster to recap each night of the World Cup, you would tell your TV to go back and find your players' finest moments or their heartbreaking mistakes.

Motion tracking has all the marks of disruptive technology, slinking on to the scene in unexpected ways. Sherry Turkle, clinical psychologist and professor at MIT, talks about "the mirroring of body motion and of course the subtle things like hand gestures, or the way someone characteristically cocks his head before speaking. Captured and incorporated into business and entertainment systems, "these motions will give us a much greater sense of connection with our online selves. The virtual will seem much closer to the real," she says. Imagine how you'll feel when your avatar smiles back from your computer screen just the way you smile. ■

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ABOVE AND BEYOND

ONLINE: Read a Q&A with James Cameron, director of *The Terminator*, *Titanic*, and *Avatar* (2009), about how motion capture spurs innovation.

ONLINE: See a slide show of how companies and research institutes have found ingenious ways to track humans in motion, from car cameras that detect drowsy drivers to wearable air-guitar shirts.

ONLINE: Explore an interactive version of the illustration on pages 62-63 showing how Nintendo, Disney, and Lockheed Martin use motion capture.

VIDEO: Learn about screens that track eyeballs...literally. See how Tobii Technology's new systems trace exactly where consumers look when they peruse an ad or a Web site.

PODCAST: Listen to Executive Editor John A. Byrne get the story behind the story from reporter Ali McConnon at www.businessweek.com/podcast

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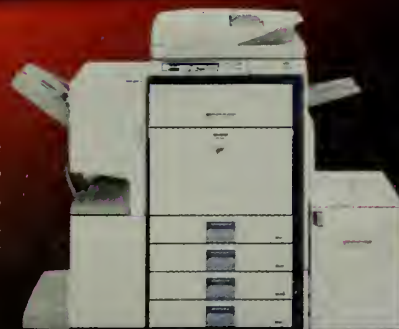


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THE RISE AND FALL OF A CORPORATE HEADHUNTER

How Jeff Christian went from Silicon Valley recruiting sensation to homicide defendant in Cleveland. **BY MICHELLE CONLIN, TOM LOWRY, AND PETER BURROWS**

FEW DOT-COM ERA headhunters labored more mightily to crack the Big Time than Jeffrey E. Christian. The tall, sharply dressed recruiter from Cleveland worked tirelessly to promote himself and his firm, Christian & Timbers. As he battled to beat out more established headhunters, Christian used a combination of doggedness, public-relations savvy, and salesmanship to sign up Silicon Valley's biggest players. He courted the national business media, often conducting phone interviews on a treadmill during marathon workouts. His name became a fixture on *The Midas List*, *Forbes'* ranking of best dealmakers. And in 1999 his position as one of the Valley's most celebrated headhunters seemed all but assured when he vanquished the acknowledged powerhouses of his industry to place Carleton S. "Carly" Fiorina at Hewlett-Packard Co. Jeff Christian, it seemed, had finally arrived.

Then the boom ended. And Christian returned to his hometown of Cleveland. In the Valley, he was largely forgotten, just another gold-rush striver who briefly cashed in and then faded away. So the surprise was palpable in executive recruiting circles when word came that Christian had been charged with reckless homicide and

DOWNHILL PATH

Counterclockwise from top left: Christian in his police mug; the overdose victim, Tom Wasil; Paws, the local watering hole where Christian and Wasil met; Fiorina, whom Christian recruited to HP; the rented house where Christian and Wasil allegedly did drugs together



“Christian was clearly the poster boy for the search industry...[from its] rise to its enormous crash.”

—SCOTT SCANLON



(CLOCKWISE FROM TOP RIGHT) BRUCE ZAKE;
YOSHIKO KUSANO/KEystone/AP PHOTO; BRUCE ZAKE

involuntary manslaughter in the overdose death of another executive recruiter, 31-year-old Thomas J. Wasil. As if that were not enough, Christian, who was indicted in December, was also charged with corrupting a juvenile and inducing others to take drugs following the nonlethal overdose of a 17-year-old in his home a month after Wasil's death. And the Wasil family plans to file a lawsuit against Christian. "Holy sh-t," said one major headhunter when *BusinessWeek* contacted him. "I had no idea," said another. "I'm shocked."

Today, Christian, who has pleaded not guilty to all charges, is out on \$150,000 bail. His first wife has taken him in at the sprawling wooded property she won in their 1996 divorce in Moreland Hills, Ohio, an upscale suburb of manicured lawns and private country clubs. Christian's two Mercedes and black Hummer H2 are often parked out front. His trial is set for Aug. 22 in Portage County, Ohio. Ever one to advocate hiring the best talent, Christian recently added to his four-member legal team famed defense attorney Thomas A. Mesereau Jr., who successfully defended Michael Jackson and actor Robert Blake. The defense, says one of Christian's attorneys, Gerald S. Gold, plans to argue that Tom Wasil was a drug abuser, a charge the Wasil family denies, and that Christian, 51, is not culpable for Wasil's death. Reached on his cell phone on Mar. 21, Christian told *BusinessWeek*: "Hopefully, when the real facts come out, they will vindicate me. I was there and know what happened and didn't happen."

Jeff Christian's rise and fall mirrors the dot-com boom and bust. His story is emblematic of what can happen when someone, through a combination of circumstance and ambition, breaks out, only to see that success evaporate. Despite spending years in Silicon Valley, Christian remained something of a nose-to-the-glass outsider. When the boom ended, his firm shriveled and he went back to the anonymity of Ohio. That's where the real trouble began. "Jeff Christian was clearly the poster boy for what occurred in the search industry from 1995 to 2000, from its magnificent rise to its enormous crash," says Scott A. Scanlon, chairman and chief executive of Hunt-Scanlon Advisors, a market research outfit specializing in recruiting. "No one firm or person epitomized this more than Jeff and Christian & Timbers."

GROWING UP IN CLEVELAND, Christian seemed destined for smaller things. The college dropout spent his early years trying to find himself: giving up meat, learning Tai Chi, meditating. He toyed with becoming an actor. It was only on the eve of his first marriage, according to his own account, that he decided to get serious. His dad owned an employment agency. And at the age of 23, Christian joined another Cleveland placement firm, R.F. Timbers & Co. They gave him the Yellow Pages and told him to get to work.

Christian had an easy chemistry with people and was great on the phone. He was also prescient, spotting a gaping opportunity that most headhunters were ignoring: technology. Within eight months of his arrival, Christian bought out Timbers and in 1980 founded Christian & Timbers. His contacts in the technology sector soon turned him on to the action in Silicon Valley. Before long, Christian was spending most of his time in California.

Breaking in wasn't easy, even for a young man with considerable charm and drive. But Christian hustled hard. Once, in the late 1980s, he persuaded venture capitalist Joe Schoendorf

to consider choosing him to do an executive search for a new software company. Schoendorf told Christian the board wanted to work with a recruiter with offices in the Valley. "Give me a couple of hours," Christian told him. Two hours later, he called Schoendorf. "I now have a California office," he said, having rented one and printed up business cards. Christian then drove to Schoendorf's house with a big chocolate apple and a bottle of Dom Perignon. He didn't land that search, but Schoendorf was impressed, and he eventually introduced him to HP's future CEO, Lewis E. "Lew" Platt. The door had swung open.

Before long, the Valley was growing desperate for talent. Eventually the scarcity would become so acute that companies began throwing in free Mercedes and six-figure signing bonuses to get bodies in the door. It was, in other words, time when anyone with energy and moxie could make a good living. Christian worked as hard as or harder than anyone, carrying multiple mobile phones long before double-fisting cell phones became common. He would call potential clients anytime, anywhere. Legendary venture capitalist John Doerr of Kleiner Perkins Caufield & Byers once got a call from Christian as he was walking into church on Sunday morning. Christian chased headlines and TV coverage relentlessly.



ENOUGH IS ENOUGH

CEO Sullivan (above) says Christian left after partners tired of covering for the founder's erratic behavior. Christian at home in better days (right); Christian & Timbers' Ohio offices

As the dot-com boom took off, Christian was in his early 40s and remarried with young kids. Domestic life didn't change him much. He practically lived at the San Francisco Ritz-Carlton or the Marriott in Silicon Valley, making weekend trips to Cleveland to visit his family and the firm with his name on the door.

Yet Christian still felt like an outsider, say people who worked with him. The college dropout was mingling with Stanford MBAs, these people say, and he never felt accepted by his colleagues, who saw him as a Midwestern interloper, a bluff showman. A former Christian & Timbers partner says Christian was "always the underdog, always having to work twice as hard. The chip was there." Christian, it seemed, hangered after membership in the gilded club of Silicon Valley ringmakers.

The opportunity to get there arrived in 1999 when HP started looking for a new CEO to replace Lew Platt. Platt, who died in 2005, liked Christian from day one. "He's hungry and passionate," Platt told *BusinessWeek* in 2002. "As a committee we were very impressed with his energy compared to some of the oth-

“I still support Christian & Timbers. If I were them, I'd get as far away from me as possible.”

—JEFF CHRISTIAN

ers in the business." Christian got the job.

His selection stunned many Valley and HP insiders. "I think they made a huge mistake," one major headhunter said at the time. "It's like giving an intern permission to do triple-bypass surgery." Many who considered the HP job were also unimpressed. Four candidates

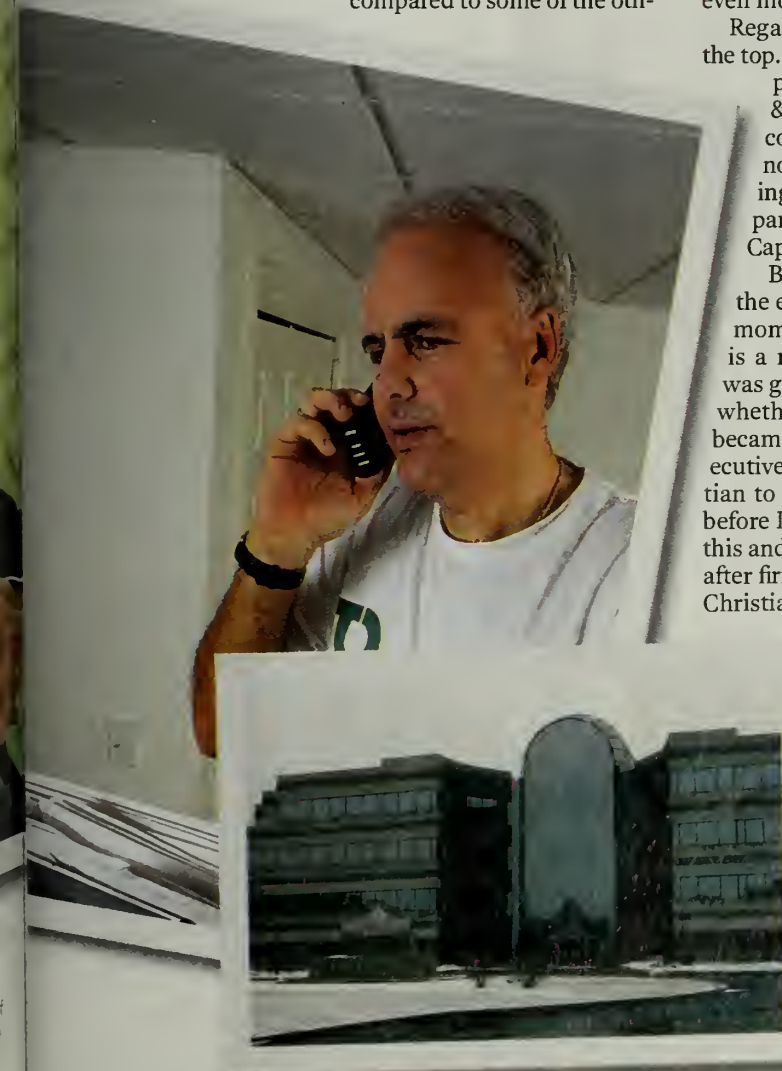
complained that Christian didn't return their phone calls. One of those was Edward J. Zander, now CEO of Motorola Inc., who was Sun Microsystems Inc.'s president at the time. Zander took himself out of the running when Christian, at the HP board's behest, asked him to take a lengthy psychological test, though people familiar with the situation say Zander also was angry because he suspected Christian may have leaked his name to the press—a taboo in the recruiting world.

The sniping from Christian's peers didn't seem to deter him. "Have I ever done a search for a CEO of a \$39 billion company?" he asked a *BusinessWeek* reporter at the time. "No. But only eight people have done a search that size. John Thompson [of Heidrick & Struggles International Inc.] hasn't." In July, 1999, HP hired Carly Fiorina—a choice that turned out to be even more controversial than Platt's hiring of Christian.

Regardless, the Fiorina coup put Christian & Timbers over the top. In 2000 the firm posted \$60.7 million in revenues, triple what it had generated three years earlier. Christian & Timbers was now the 7th-largest search outfit in the country, up from 14th in 1997. The phones were ringing nonstop. "Working there was like riding the most exciting bronco in the corral," recalls Marc Lewis, a former partner who is now the CEO of search firm Leadership Capital Group in Westport, Conn.

But trouble was brewing. Cracks were appearing in the economy. And the dot-com boom seemed to be losing momentum. People working with Christian, who says he is a member of Alcoholics Anonymous, say the pressure was getting to him, and there were persistent rumors about whether he had fallen off the wagon. His work habits also became an issue again. Ray Lane, a former Oracle Corp. executive who had by then joined Kleiner Perkins, hired Christian to recruit a CEO for one of his startups. It wasn't long before Lane was regretting his choice. "I think you delegated this and did not do a good job," Lane recalls telling Christian, after firing his firm. Lane says he "kissed and made up" with Christian but notes bemusedly that Christian "became a brand at the end of the bubble."

The crash hit everyone hard, including Christian & Timbers. By 2002 revenues had shrunk by 55% from the 2000 peak. People working there at the time say Christian, who had returned to Cleveland, was becoming increasingly erratic. One former partner says that in the summer of 2002, Siebel Systems Inc., now part of Oracle, hired the firm to find a head of worldwide sales. Christian was jubilant at winning the new business but soon disappeared. Months later he resurfaced, the former partner says, and took credit for the successful placement. Zack Simon, another partner at the time, also recalls long absences that clients were totally unaware of. "It was easy to cover up," Simon recalls. "You just said: 'He's not here,' or

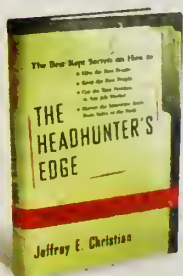


that he was traveling."

Before long, Christian was having problems with his partners, who, after trying to get him help, began agitating for his departure. The partners, who include Christian's half-brother, Adam P. Kohn, wanted to bring in Brian Sullivan, a well-regarded recruiter, as CEO. Sullivan had earlier sold his firm to Heidrick & Struggles. "The partners gave him the benefit of the doubt a number of times," Sullivan told *BusinessWeek*. "[But] Christian wasn't working, and the partners said: 'Enough is enough. We're sorry. No más.'" Christian, who sold his stake in 2003, says he wasn't forced out but left to care for his dying mother.

It was about this time that a young Cleveland headhunter named Tom Wasil met Jeff Christian in a bar called Paws, just down the road from both of their houses. All Wasil had heard about Christian was that he was a recruiting legend who had recently published a book called *The Headhunter's Edge*, a manifesto on getting and keeping top talent. By all accounts, the two men hit it off right away. Here were two guys who could chat up anybody. Christian offered to be Wasil's mentor. Wasil was thrilled. In Christian, he saw who he wanted to be: a major leaguer with big houses, luxury cars, and an outsize reputation. For Christian, Wasil was in many ways a reminder of his younger self.

Around this time, Christian seemed to have been thinking a lot about youth. He fell in love with an attractive 18-year-old who waitressed at a well-known local bar. He dyed his white hair auburn. People who hung out with him at the time say he routinely had limos idling in front of his house—a rental in the exclusive, gated golf community Barrington Estates—just in case there were parties to hit. Neighbors started to complain about his own gatherings. He would leave slurred voice mails for friends, telling them about the latest after-parties following Cleveland Cavaliers games or inviting them to come over. He was generous, lending his Hummer to whoever needed it.



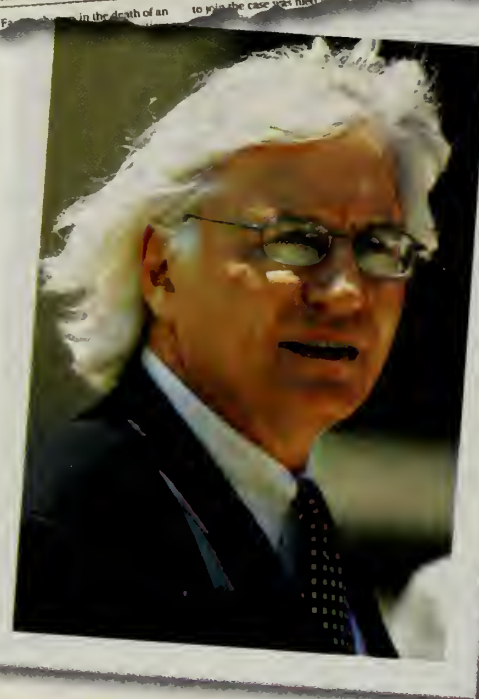
Christian's talent manifesto was published just after he arrived back in his hometown

FEBRUARY 19-25, 2007

Star lawyer may aid Christian's defense

Attorneys for indicted search firm founder seek OK to add Michael Jackson attorney Mesereau

By JOHN BOOTH
booth@cleveland.com



CELEBRITY COUNSEL

Christian recently drafted Michael Jackson's attorney Mesereau for his legal team

sion to make a four-day trip to California. Mr. Mesereau's law offices are in Los Angeles.

The motion was among a flurry of recent filings by Mr. Christian's attorneys that offer glimpses into the case. The filings include references to alleged drug activity at Mr. Christian's

indicted Mr. Christian in connection with the April 12, 2006, drug overdose death of 31-year-old Thomas J. Wasil.

Mr. Christian pleaded not guilty to those felony charges, which also included permitting drug abuse

for April 17 and a pre-trial hearing is scheduled for May 14. The trial is scheduled to begin May 15.

On Jan. 18, Cleveland defense attorney Jerry Gold, one of 1 Christian's lawyers, filed a request for a bill of particulars, asking his

The day before he died, Wasil borrowed the Hummer to tow his ski boat. On Apr. 11, 2006, Wasil and his girlfriend Lauren Swanson, drove to Christian's house around midnight to return the vehicle. According to court documents the state alleges Wasil, Swanson, and Christian drank alcohol and took cocaine and that Wasil and Swanson used a hot tub. The state also alleges that Christian produced a brown powder that was described as opium and that Wasil used the substance. Before he left Christian's house early that morning, Wasil is alleged to have done one more line of drugs and then driven home.

When Swanson found Wasil later that day in their Reminderville (Ohio) home he looked like he was sleeping. He was lying on his right side, his sheets tucked crisply into the sides of his bed. Wasil's fists were curled under his chin, his knees pulled into a semi-fetal position.

The sirens that soon blared through Wasil's neighborhood sent a sickening pang through the lakeside enclave, a place filled with ambitious young professionals and their families. A crowd of friends and neighbors gathered outside Wasil's 1,200-square-foot bungalow. By the time the medical examiner arrived, blood-tinged foam was oozing from Wasil's mouth and nose. He had been dead several hours, and it looked like a drug overdose.

Yet from the beginning, police suspected that nothing about Wasil's death was routine. Then, almost a month later, the 18-year-old brother of Christian's girlfriend, who was 18 at the time overdosed in Christian's house, watching a Cavs game. An ambulance took him away, and he later recovered. By then Portage County investigators were taking a hard look at Christian.

Today Christian is awaiting trial. His legal team is planning his defense and has dispatched private investigators to dig up information about witnesses. In the meantime, Christian says he has raised a \$44 million fund with top-shelf VCs. Otherwise, he keeps a low profile, taking his three sons, 5, 7, and 11 to "Ninja Night" at the local school and on court-sanctioned holidays in Florida, where they were vacationing as *BusinessWeek* went to press.

At his old firm, Christian & Timbers, business is good. CEO Sullivan says revenues have zoomed past the boom-time peak to \$77 million, thanks in large part to a concerted push into the blazing financial-services industry. "I still support Christian & Timbers," says Christian. "This is a hard time for them to weather. If I were them I'd get as far away from me as possible."

As he wrote in *The Headhunter's Edge*: "Nothing will derail a career faster than the whiff of scandal." ■

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The Making Of a Sports Mogul

How Casey Wasserman is building a sports-marketing machine for the Digital Age

BY RONALD GROVER

WHEN CASEY WASSERMAN was a lad, Sundays meant tagging along with his granddad, MCA chief Lew Wasserman, to the famously downscale Beverly Hills deli Nate 'n Al. There, while young Casey enjoyed his *matzoh brei* and jam, Hollywood players on the make would stream by the table, pitching projects, asking favors, or just schmoozing with the man who all but invented the modern studio system.

"It was like a college education on how to do business and treat people," recalls movie producer Steve Tisch, who used to frequent Nate 'n Al with his father, Wasserman friend and former Loews Chairman Preston R. Tisch, now deceased.

Casey, by all accounts, learned those lessons well. Now 32, he is in the middle of building a sprawling sports marketing agency, Wasserman Media Group—a challenger to the behemoth of the business, IMG. After a four-year spree of acquisition by checkbook, WMG today represents 400-odd clients, including 6 of the top 30 picks in last year's NBA draft. Its corporate customers include T-Mobile, Procter & Gamble, and Nestlé.

And last summer, Wasserman was selected—over competitors like IMG and the William Morris Agency—to sell naming rights to the planned New York Giants and Jets \$1 billion-plus stadium in New Jersey. The Giants' chairman? Steve Tisch. But Tisch says it was his partners who "were totally taken with how smart Casey was." That coup came right after the hefty fee—an estimated \$17 mil-

lion over the life of the agreement—that WMG pulled down in the \$178 million deal it struck with Emirates airline to put the carrier's name on English soccer team Arsenal's new stadium. All told, WMG's annual revenues approach \$100 million, says Wasserman.

STARTUP ON STEROIDS

NOT BAD CONSIDERING that eight years ago, Wasserman was a rookie sports owner who had plunked down \$5 million for the Los Angeles Avengers of the then-shaky Arena Football League. Wasserman could have gone into show biz, of course, but chose to step away from the shadow of his famous granddad. "If you're Michael Jordan's kid, you had better be one heck of a basketball player,"

he says. Today, the Avengers franchise is worth \$25 million, though like most sports teams it still makes no money. Wasserman calls the Avengers experience his "MBA in sports."

If the Avengers was Wasserman's MBA, WMG is his startup on steroids. By garnering fees of 5% or so for negotiating player contracts and up to 15% for naming rights, the agency is profitable, Wasserman says, though he declines to

recite numbers. WMG, for example, will book an estimated \$1 million a year for six years from the \$100 million contract with the Houston Astros that slugger Carlos Lee signed in 2006.

But Wasserman's biggest potential payoff? He says it's taking his athletes digital with a dizzying assortment of online sports channels and video-on-demand offerings for cable. According to ESPN Executive Vice-President John Skipper, the network is negotiating for

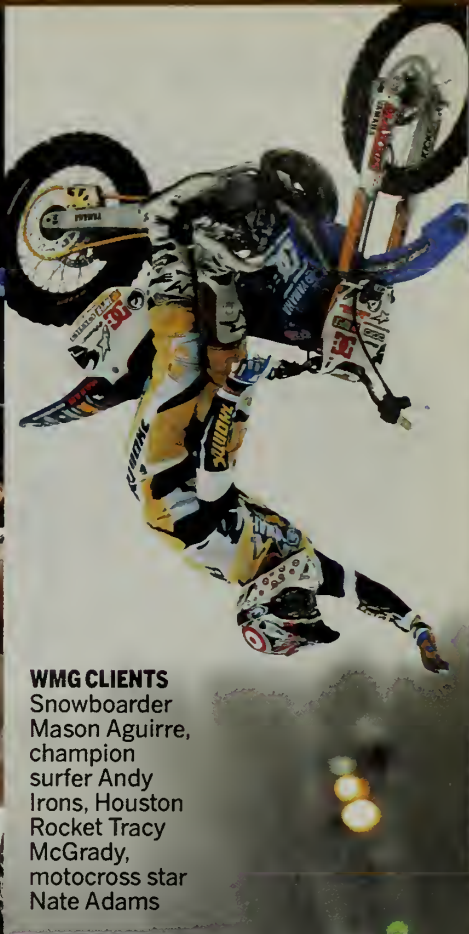
His mother let him skip school to intern for the NFL's annual Pro Bowl



its online action-sports site, EXPN, and carry content from Wasserman's planned SportNet channel, which will feature sizzling young stars like 17-year-old skateboard champ Ryan Sheckler. And he said to be talking to cable giant Comcast Corp. about video-on-demand clips such as motocross races with dirt-bike star Nate Adams. He also intends to launch SportNet with coverage of popular amateur events including pre-Olympic swimming, track and field, and gymnastics.

In 2004, Wasserman bought an outfit called Studio411 for its ability to produce and distribute DVDs. It's to be the backbone of his digital-production effort, enabling him to provide shows and other content that he can put online and off to cable and iTunes. Last year it released 37 titles on surfing, snowboarding, motocross, and other action sports for companies with names like Moonshine Conspiracy, PoorSpeciman, and Poor Boyz.

Wasserman, however, isn't alone in his broadband dreams. To create SportNet he'll have to beat out well-connected competitors including the U.S. Olympic Committee, which has offered more to secure online rights from some of the same governing bodies with which Wasserman is negotiating. And the project of larger media companies, including Fox Cable Networks' Fuel channel, envision their own action-sports services. "Casey is doing is adding to the confusion,"



WMG CLIENTS

Snowboarder
Mason Aguirre,
champion
surfer Andy
Irons, Houston
Rockets Tracy
McGrady,
motocross star
Nate Adams

and maybe hurting things for everyone," says Wade Martin, president of the Dew Action Sports Tour, which stages a series of events sponsored by Mountain Dew.

More important, there's head-scratching among veteran sports marketers as Wasserman spends heartily to push

into the business while major operations like SFX Sports Group and IMG are trimming back (page 64). When superstar agent Arn Tellem left SFX, a spin-off from Clear Channel Communications Inc., in January, 2006, Wasserman ponied up \$12 million for his practice, industry sources estimate. When SFX wanted out of Europe, Wasserman bought its soccer, rugby, and marketing divisions. When old-line ad agency Fahlgren & Co. put its auto-racing marketing unit, Champion Sports Group, up for sale, Wasserman grabbed it and was suddenly in NASCAR. He's like the guy who walks up to this great buffet and picks up things here and there but hasn't decided if he likes Mexican food or

steak," says Donald Dell, SFX senior vice-president and founder of ProServ. "I don't think he has really decided on a game plan." WMG Chief Operating Officer Josh Swartz says the distressed assets came cheaply.

Wasserman came by his interest in sports through his mother, who took him to Los Angeles Dodger games and let him skip school to intern in Hawaii for the NFL's annual Pro Bowl.



Casey's World

All of 32, Casey Wasserman is building a sports empire that is approaching \$100 million in revenues. Some hot spots:

AGENT EXTRAORDINAIRE While major outfits like SFX and IMG dumped agents, Wasserman bought up practices of folks like basketball superagent Arn Tellem. Clients include MLB, NBA, soccer, and young action sports stars.

NAME THAT STADIUM After buying sports naming-rights guru Jeff Knapple's Envision firm, expanded into sports marketing and sponsorship. Won beauty contest with William Morris and IMG to put corporate names on \$1 billion Giants/Jets stadium in New Jersey.

MEDIA MOGUL IN TRAINING Like grandfather, the late Lew Wasserman, sees a media play in agencies and talent. Bought action-sports DVD producer Studio411 to provide foundation for move into online distribution of action sports channels, video on demand.

THE LOS ANGELES AVENGERS Plunked down \$5 million for an indoor pro football team now worth north of \$25 million.

A top-ranked California high-school tennis player, he suffered knee problems and turned to golf.

After graduating from the University of California at Los Angeles in 1996 with a degree in political science, Wasserman made a false start or two: He tried his hand in the bond market, then had a fling at launching a music label with the band Coldplay before turning his attention full-time to sports.

Today, Wasserman fields an all-star team that includes agent Tellem and naming rights guru Jeff Knapple, a former Denver Broncos quarterback with \$2 billion in sponsorship deals under his belt. Last July, Wasserman signed up IMG's top marketing executive, Robert Prazmark, who generated more than \$500 million in sponsorship deals over nine years. And in recent weeks he has hired several young agents, among them Jay Danzi, whom he snatched from IMG and who'll launch a golf representation division.

But that doesn't mean Wasserman is watching from the sidelines. He and Knapple worked together

Data: BusinessWeek, Wasserman Media Group

to land the Giants/Jets deal, says Tisch. Wasserman also played a key role in last year's agreement with ESPN to show Arena Football games and take a 5% stake in the league. "When the deal was signed, Casey wanted to talk marketing, like how much exposure were we going to give the league," says ESPN Executive Vice-President John Skipper. "Put a bag

over his head, and he wouldn't sound like any 32-year-old I know."

Wasserman may be wise beyond his years, but he also has two other things going for him: money and solid-gold connections. What other junior mogul can get a former President to chat up a reporter about his potential? Bill Clinton, who became friends with Lew Was-

serman when, as governor of Arkansas he encouraged him to make more movies in the state, currently has Casey on his library board and says he may be a chip off the old block. "A lot of folks from comfortable beginnings do things their own way, good and bad," says Clinton. "You can tell that Casey was listening [to his granddad]." ■

Why Did IMG Let All Those Stars Walk?

It seems an odd strategy for sports marketing powerhouse IMG: Build the business by letting your star athletes leave. But that's exactly the path IMG is taking these days. Certainly not all its athletes are making for the exits. IMG still crosses the T's on Tiger Woods' Nike deals and makes sure Roger Federer's Wilson rackets are strung. But since private equity mogul Theodore J. "Ted" Forstmann spent \$750 million for the company in 2004, IMG hasn't been the glitzy campus for sports studs that it used to be.

The question swirling around IMG: Is that transformation part of Forstmann's new strategy to expand the business in profitable, new directions—or a fumble that cost the company \$30 million-plus?

One thing is clear: Last summer, IMG got out of the team-sports business. The move came after a shake-up that resulted in Forstmann firing one of the company's senior executives, Peter Johnson. A few months later two of the company's top sports agents left IMG, taking their clients, including baseball's Derek Jeter and football hotshots Peyton Manning and LaDainian Tomlinson, with them.

Johnson, then IMG's CEO of sports and entertainment and a loyalist of the firm's late founder, Mark McCormack, oversaw the agency's team-sports business. A 30-year IMG veteran, Johnson had close ties with Tom Condon, who represented football clients, and with baseball agent Casey Close. The relationship was so tight that both agents had "key man" clauses in their employment contracts giving them the right to leave IMG if Johnson ever departed. Four months after Johnson was fired, Condon and Close sold their practices to Creative Artists Agency Inc. Condon, whose

lineup of 75 National Football League players established IMG as a football power, collected \$30 million.

Competitors are still amazed over how simply Close and Condon were able to leave IMG and take their clients. "Nothing like that has happened that I know of," says Donald L. Dell, the pioneering sports lawyer who founded the ProServ agency, now called SFX Sports Group Inc. "I don't think Teddy was in favor of just giving away his assets."

The notion that the team-sports heroes weren't worth keeping around doesn't fly outside IMG. "Everybody in this business wants to go to the Super Bowl and throw the hip party surrounded by the superstar quarterback," observes a prominent agent. "Teddy is no different."

Adding to the confusion, IMG attempted to jump back into the football biz, chatting up replacements for Condon in the months after he left the agency. That has fed speculation, including inside IMG, that Forstmann might have been unaware of details in the agents' contracts.

Forstmann declined to comment for this article. But sources familiar with IMG say the speculation is baseless and that Forstmann knew all along that he risked losing Condon and Close because of the clauses in their contracts. Besides, they say, team sports accounted for only a tiny fraction of IMG's total income, and repping team-sports figures sometimes makes it complicated to strike other deals with leagues and owners—a far more lucrative business. Finally, they point out that IMG profits are about three times higher now than when Forstmann bought it. So the company that all but gave away Derek Jeter doesn't seem to be having much post-parting remorse.

—By Mark Hyman



IN THE ROUGH?
IMG owner
Forstmann

A Takeover Road Less Traveled

Canadian parts maker Magna has a plan for buying Chrysler—and it's not that outrageous

BY DAVID WELCH AND
JAIL EDMONDSON

CANADIAN AUTO PARTS maker Magna International Inc. may have a low profile, but its ambitions have always been lofty. Last fall the company invited journalists to its U.S. headquarters north of Detroit to see a single-seat orange sports car designed, engineered, and built from the ground up by Magna. August Hofbauer, North American president of the Magna Steyr division that assembles completed cars for several major carmakers, beamed proudly as he said: "We developed this vehicle from concept to production." He went on to say that "we can take over everything from the carmakers."

Maybe even a whole company. The \$24 billion Magna has emerged as a legitimate candidate to buy Chrysler Group, possibly in combination with a private equity firm. On the surface, buying Chrysler would seem a madcap venture for Magna Chairman Frank Stronach. The deal would instantly put him in competition with many of his biggest parts-buying clients, potentially driving some of them away. Moreover, Magna's test balance sheet shows a surplus of only \$1.9 billion. Depending on how a deal is structured, Magna may have to go into debt to buy the company or fix its multitude of problems.

But Stronach, 74, an Austrian-born Canadian who declined to speak to *BusinessWeek*, is nothing if not an unconventional thinker. He has pushed



CHRYSLER 300 Magna makes it in Austria

Magna from parts making to carmaking, plunged headlong into such ventures as thoroughbred racing, and once put his daughter at the company's helm when she was just 34. "Frank is a fountain of provocative ideas," says longtime industry watcher John A. Casesa, a partner in the consulting firm Casesa Shapiro Group. "Some of them are crazy. There is a constant tension between him and the team to control him."

Stronach recently told Canadian Auto Workers President Buzz Hargrove that he is not worried about the prospect of alienating customers if he takes over Chrysler. "I brought it up with Frank," Hargrove recalls, "and his position was that they have the best quality, technology, and delivery, so people will still want to buy from them."

There is no doubt that Stronach's team has some of the key skills necessary to run Chrysler. Its factory in Graz, Austria, builds 260,000 cars a year, assembling eight models on seven platforms for four different carmakers. Its 42 defects per 100 vehicles make it the top-quality assembly plant in Europe, says J.D. Power & Associates. The custom manufacturing part of the business grew 8% last year, to \$4.4 billion, thanks to a 19% jump in the fourth quarter, and its profitability helped mitigate a shortfall in Magna's core automotive parts business. Overall, Magna's 2006 profits fell 17%, to \$528 million, as higher raw materials costs and lower prices from the automakers made life tough for most parts makers.

One of the reasons Magna hasn't suffered the fate of the many bankrupt companies in the parts business is that Stronach is a savvy strategist. While

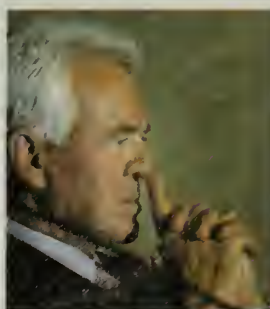
many parts makers have taken low-margin contracts with the Big Three just to boost sales, Magna has passed on risky parts deals with Detroit.

A JOINT BID?

STRONACH IS GOOD at managing his fortunes. But reversing Chrysler's would be quite another matter. Even if Stronach could come up with the money to buy Chrysler (one source bidding on the carmaker says parent DaimlerChrysler wants \$6 billion to \$8 billion), he may need even more cash to fix future problems. Plus, Magna has never dealt with car dealers or had to try to tap into the psyche of American consumers to try to figure out what the next hit vehicle will be. Says KeyBanc Capital Markets analyst Brett D. Hoselton: "I doubt Magna is really excited about getting into the marketing and distribution side of the business."

More likely, Magna could end up as one partner in a consortium buying Chrysler. Several sources close to Daimler's sale efforts have said that Magna could form a joint bid with a private equity player. One Magna executive says Cerberus Capital Management—the New York firm that bought 51% of GM's GMAC finance arm and is a Chrysler bidder—could be one such partner. A partner like Cerberus could raise money and take a majority stake. Magna could run the plants and build the cars, which it already does on a smaller scale.

For Stronach, who started building his empire in the Fifties, running a company the size of Chrysler "would be a natural progression," says KeyBanc's Hoselton. ■



STRONACH Canny management helped him sidestep a downturn

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What Do 35-Year-Old Women Want?

As other stores stumble, Bloomie's Quotation boutiques are going after these busy shoppers

BY ELIZABETH WOYKE

BLOOMINGDALE'S INC. IS pursuing "yummy mommies." That's what the chain has dubbed the stylish 35-to-45-year-olds it's courting with a store-within-a-store boutique called Quotation. These women may have gone up a size post-baby but are adamant that motherhood is not synonymous with looking matronly.

Other retailers have tried and failed to win over this elusive demographic. In January, Gymboree Corp., known for its children's clothing, shuttered Janeville, its brand for women in their mid-30s and older. Soon after, Gap Inc. announced it would close its Forth & Towne division, which targeted a similar shopper. And American Eagle Outfitters is retooling the women's line at Martin + Osa, its six-month-old chain for the 25-to-40 crowd.

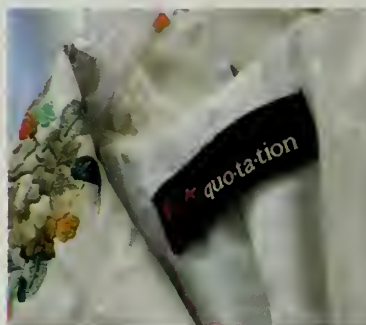
Why does Bloomingdale's think it can prosper where so many have floundered? The company says it's homing in on a slimmer slice of the market: affluent, suburban, casual yet fashionable moms. It's moving aggressively, going from six boutiques in mid-2006 to 16 today, and into all 32 of its outlets by 2008 or '09. Analysts approve of the tighter focus: "With Forth & Towne and Janeville, you didn't know who was buying these clothes and what for," says Adrienne Tennant, a retail analyst at Friedman, Billings, Ramsey Group Inc. "They didn't have an obvious reason for being."

Liz Jones, a Bloomingdale's divisional merchandise manager, and Erica Ruff, a buyer, say they know exactly what the Quotation woman wants. They've lived

inside her head since spring of 2005 when Frank Doroff, Bloomingdale's senior executive vice-president, asked them to create a boutique that would appeal to the stylish mothers in his Westchester County (N.Y.) hometown. With input from the marketing and research departments, they discovered a customer who considered the store's classic sportswear brands (Jones New York, Calvin Klein) too formal and found its contemporary sportswear (Juicy Couture, Marc by Marc Jacobs) too young. She shopped at Bloomie's for her family but favored boutiques for herself. She wasn't a clothes horse but wanted clothes that looked pretty and feminine with a little flair and forgiving fit.

The boutiques' department store location should appeal to moms looking for one

VARIETY Prices range from \$500 for this embroidered jacket to \$25 for a tank top



stop shopping, says Tony Gao, a marketing professor at Northeastern University. While the look is sleek, with walls featuring quotes from Diana Vreeland and Katharine Hepburn, convenience is key. The clothes, chosen from 20 independent designers and a private label line, are arranged with scenarios in mind—soccer practice, a parent-teacher conference, coffee with friends, or couples' night out.

So far, Doroff says Quotation's double-digit sales growth has "far exceeded our plans." He would not share specific figures or profit numbers. But with space on Bloomie's busy women's sportswear floor at a premium, Quotation must keep proving itself or risk being kicked out of the nest. ■



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As the World Wide Web Turns

Can producing soap operas for online viewers breathe new life into daytime programming?

BY TOM LOWRY

IN LATE FEBRUARY, CBS launched a Web-only soap opera called *L.A. Diaries* it hopes will attract young women. The nine episodes are streamed for about six minutes a pop on the network's innertube.com site. The action centers on Amber, an existing character on *The Young & the Restless*, and on Alison, a new character who emerged from the cyberspace soap on Mar. 21 to play an actual role on TV in *As the World Turns*.

It's a fresh approach to creating buzz for a TV staple, and other network executives will be watching closely. Rival networks are trying to get kids to watch old daytime melodramas such as *General Hospital* and *Days of Our Lives*, shows their mothers or grandmothers might have watched.

Few genres have demonstrated more staying power than the soap opera. More than half a century after first airing alongside the detergent commercials that gave



them their name, soaps still captivate millions of mostly women fans. No matter how preposterous the dialogue or cheesy the plot lines, soaps have, in modern parlance, a "stickiness" that many prime-time dramas can only hope to achieve.

Characters like newspaper publisher Victoria Lord Davidson of *One Life to Live* (who made her debut on the show in 1968) have been on the tube for so long that they can seem like old friends. "I feel I really know them," says Antonella Cahill, a 40-year-old Philadelphia secretary and soap fan who named one daughter after the scheming Nikki Newman of *The*

L.A. DIARIES
CBS streams the drama on its innertube.com Web site

Young & the Restless and the other after *General Hospital's* Tiffany Hill (who married and left beloved Port Charles years ago). Even better, as far as soap fans are concerned, the networks don't stint on new episodes; last year, ABC rolled out 251 new *General Hospital* episodes vs. 23 new *Desperate Housewives* shows.

But even as the shows' stars age gracefully (cue makeup, soft focus, and cosmetic surgery), there is no hiding the graying of their fans. There are new plot devices and characters—a teen girl's right to choose, for one—calculated to appeal to young women. Even so, most soap devotees are well over 50. Meanwhile, over the past decade, viewership has fallen 35%, to 30 million viewers a day. Hence the networks' eagerness to reimagine the soaps for a new generation.

It goes without saying that the Web is where the action is, but so far the networks haven't been able to win the digital rights to put them on their own sites. Until ABC, NBC, and CBS hammer out a deal with the production companies that make the soaps, few will be available to download or stream. There's plenty of upside in getting the deals done. Media consultant Tom Wolzien figures there are more than 20 million women in the workplace with broadband access. So streaming shows live to computers could

AVID FAN Cahill named both her daughters for soap characters

double the potential audience for soaps. If you got just 5% of those working women to watch, Wolzien calculates, the net

works could reap an extra \$230 million a year in advertising.

In the meantime, the networks are taking baby steps online. SoapNet, the Walt Disney Co.-owned channel that shows soaps at night for working women, sponsors online soap fantasy leagues. Participants rack up points when character they have picked for their team take on their shirts, say, or switch the paternity test results. Still, the players number less than 30,000. The channel is also asking college kids to create their own soap and put them to the vote at soapnet.com. Even CBS's *Guiding Light* is getting on the act, podcasting the show, which began life on radio in 1937.

If the soap opera is to be around for another half-century, the networks will have to make converts of a generation with a thousand more entertainment choices than their grandmothers. "It's constant," says Barbara Bloom, senior vice-president for daytime programming at CBS, "is making viewers always emotionally involved in the story." ■

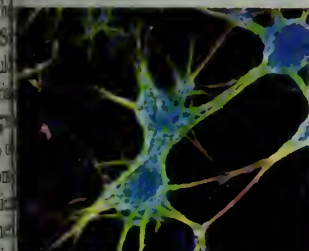


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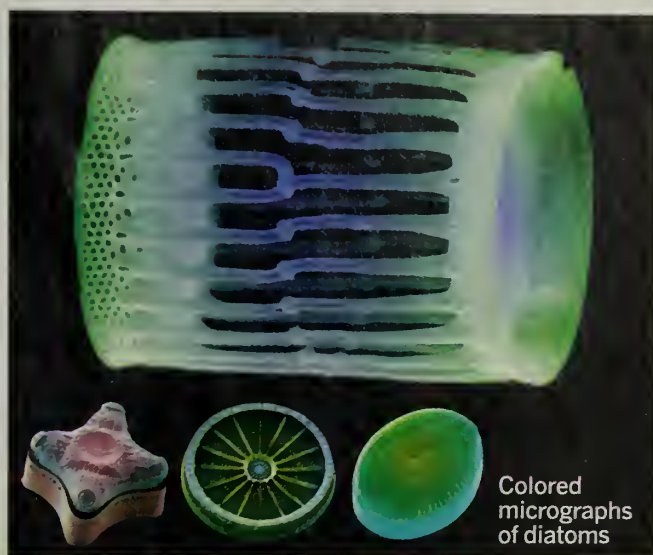
Of neural sound waves and raging hormones

»Every day, millions of people undergo medical procedures requiring anesthesia. Yet the mechanism that produces this somnolent state is unknown. Physicists Thomas Heimburg and Andrew Jackson at the University of Copenhagen have presented evidence for a radical explanation: sound waves. Their research, if correct, challenges the conventional wisdom that nerves are switched on or off by electrical currents. "The information that is



encoded in the nerve pulse comes from electrical energy, but the way it is carried, we believe, is by pressure waves such as sound," says Jackson.

»Here's another neural enigma: the cause of violent mood swings among teenagers. Researchers at SUNY Downstate Medical Center propose in *Nature Neuroscience* that a hormone called THP, which normally has a tranquilizing effect, reverses its role in adolescence and triggers anxiety. The hormone interacts with a brain receptor called GABA-A, which is associated with relaxed states and is the target of many sedative drugs. —Kerry Capell



Colored micrographs of diatoms

MATERIALS SCIENCE MORE THAN JUST A PRETTY CARAPACE

DESIGNERS of sensors and other electronic parts have found a rich source of inspiration: microscopic sea creatures called diatoms. Scientists say there may be 100,000 different species of these tiny plankton, which are encased in intricate silicon-dioxide shells. The profusion of shapes drew the attention of Kenneth H. Sandhage, professor of materials science at Georgia Institute of Technology, who

has already used one diatom as the basis for a new class of gas sensor to detect the pollutant nitric oxide.

Diatoms have many attractive traits beyond their innate beauty. The shells are porous and have a lot of surface area, and can be converted to silicon, the base material for most semiconductors. Best of all, diatoms self-assemble, so if you find or breed a shape you like, nature can do the rest.

MEDICINE TRIMMING AWAY SICK CELLS

GASTRIC REFLUX, caused by stomach acid backing up into the esophagus, afflicts millions of adults. About 10% of chronic sufferers go on to develop Barrett's esophagus, a condition that can turn into esophageal cancer, which killed 14,000 in the U.S. last year. To avoid that, doctors sometimes have to burn away tissue with lasers or remove part of the esophagus.

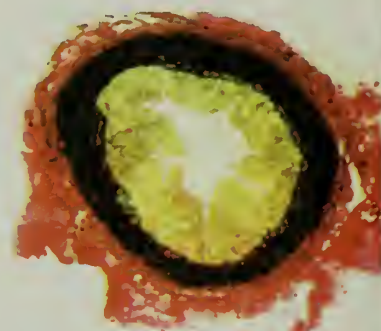
BARRX Medical, a private company in Sunnyvale, Calif., has a better way to remove diseased cells. Its HALO90 system consists of a tiny electrode attached to the tip of an endoscope, which allows the doctor to focus heat precisely on the diseased tissue. On the market since last year, the device is racking up positive clinical data, some of which will be released in May. It shows a 98% cure rate after 3 years, according to BARRX. The procedure takes less than 26 minutes to perform on an outpatient basis.

—Catherine Arnst

MEDICAL TECHNOLOGY WHEN STENTS DON'T MAKE SENSE

STENTS USED TO prop open arteries are known to cause blood clots and heart attacks in some patients. There are other problems: They are often misplaced in the blood vessel. And because doctors lack the means to examine plaque on the walls of arteries, they end up using stents on patients who might not need them. What's more, standard angiograms peer into arteries from the outside, so all blood vessels narrowed by plaque look pretty much the same. As a result, doctors simply insert stents at the narrow points.

Volcano, a medical-device maker, tackles these problems with a tiny catheter that has 64 ultrasound transducers. The device bounces sound waves off the artery walls from within, showing details angiograms don't reveal. This system



can distinguish among eight different kinds of plaque, only some of which are likely to rupture and cause heart attacks.

Volcano is also able to measure pressure differences in the vessel, showing how much a particular narrowing is affecting blood flow. If both of those technologies were widely used, the company contends, doctors would stint on stents. —John Carey

Flying Back To Life

A reservist's tour of duty left his chopper business on the brink

BY JEREMY D. QUITTNER

JEFFREY LINSOTT, 44, a helicopter pilot with 22 years of military service, is renowned for his ability to fly over tricky terrain. Michael Jackson, director of the Plate Boundary Observatory, relies on Linscott's Portland (Ore.) company, JL Aviation, to lower and retrieve sensitive instruments near Mt. St. Helens. Linscott "has one of the best feels for air flow over mountains I have ever seen," says Jackson. "He is a bit of a Zen master."

But for Linscott, salvaging his business after his most recent tour of duty with the U.S. Air Force Reserves has been anything but easy. When he was called up in 2002 his helicopter service had eight employees and \$770,000 in revenues. Then Linscott spent eight months stationed in Gulfport, Miss., where he lost even once-a-day contact with his employees, never mind his clients and vendors. He returned to a business close to ruin. His employees had quit, he was down to one helicopter from three, and eight months' revenues amounted to only \$35,000. Yet he still owed \$40,000 a month to creditors. Meanwhile, his wife had left him. Says Linscott: "I was destroyed."

About 55,000 reservists and National Guard are self-employed, and about twice as many work for small companies, according to a May, 2005, Congressional Budget Office report. And, like Linscott's, their deployments give rise to a host of troubles, from the loss of revenues to permanent shutdowns. "No one is there



THE RIGHT STUFF
Linscott flew Black Hawks in the Reserves

to help [soldier-entrepreneurs] figure out how to maintain their business when they are gone," says Paul Rieckhoff, executive director of Iraq & Afghanistan Veterans of America, a New York lobbying group. Scott Denniston, director of the Office of Small and Disadvantaged Business Utilization and the Center for Veterans Enterprise for the Veterans Affairs Dept., says that while some services are available, most National Guard members and reservists don't know about them. He says the Small Business Administration is working with the Defense Dept. to get information to soldiers before they are deployed, not after.

Linscott could have used it. A Black Hawk pilot, he completed about 60 tours of duty, including combat in the Gulf War. After working for another aviation service, he started his own. His first clients were local sheriffs' offices that wanted to fly reconnaissance to stamp out marijuana growers.

Unlike employees of larger companies, Linscott had few choices, and no safety net, when it came to his absence. "You can't be the president of a helicopter service and be on active duty simultaneously," says Linscott. "I can't run JL Aviation from afar." He asked another pilot and his director of aircraft maintenance to run the business. But the company became embroiled in a costly legal fight over a turbine, grounding one heli-

copter. (A judge later ruled in Linscott favor.) A second leased craft had to be returned because Linscott wasn't the one to fly it. "We did not have the capacity for new customers," Linscott says.

While still on base, Linscott saw a spot on CNN about the SBA's Military Reserve Economic Injury Disaster Loans. Linscott was told to apply through a disaster recovery center in San Diego, which required bank statements, tax returns, and written statements from accountants and creditors—things Linscott could not gather from Mississippi. Back in Portland, in the summer of 2003, a counselor with the Service Corps of Retired Executives helped Linscott assemble a new business plan and loan documentation. It took six months for Linscott to receive \$472,000.

Rebuilding began with the purchase of a new turbine. Linscott's stable of regular customers was down to 4 from 2,000, so he worked the phones to bring in jobs. He also chased more commercial work, flying photographers who need aerial views of natural wonders such as the Columbia River Gorge, a catering to guys who want to propose to their girlfriends thousands of feet up. Revenues are climbing, and Linscott, now retired from the Reserves, hopes soon to have a third helicopter and increase staff from four to eight. Says Linscott: "Three years later, we have almost recovered." ■

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Unions: The Great Divide

Our columnists raised an issue of urgency to business—and set off a spirited debate

ON MAR. 1, THE HOUSE PASSED the Employee Free Choice Act, a bill that would change the rules of labor elections by replacing the secret ballot with “card check,” a system allowing for union certification if a majority of workers simply signs up. In their Mar. 12 WelchWay column, “The unemployment act,” Jack and Suzy Welch noted that the bill had been flying under the public radar and blasted it as an insidious threat to U.S. competitiveness. That set off a deluge of letters and e-mails. On at least one point, the Welches were unassailably correct: Many readers were unaware of the bill and thanked Jack and Suzy for bringing it to their attention.

» Sorry, Jack and Suzy, but your anti-union mindset hasn’t moved much past 1912. Unless you have been living in a cave (or the penthouse suite), employers introduced “intimidation,” as you fear unions will, long ago.

As for the bloated economy of the 1970s and 1980s being the fault of labor, that was as much a collapse in managerial leadership as well as the work ethic. Remember, it was the design engineering committee that gave us the fabulous Vega, Pinto, and Maverick—not the American union worker.

Need more reassurance that unions won’t kill our economy? Look at Southwest and Delta Air Lines. One is a robust business, the other is in bankruptcy. Guess which company is heavily unionized and which is not?

*Steve Filson
Danville, Calif.*

» As a former union activist who has been helping companies fight off unionization attempts, I have been attempting to draw attention for nearly two years to the devastating impact that the EFCA will have on U.S. companies and their workers. Unfortunately, business has been late on this one and still seems to be missing the boat. Although President Bush has vowed a veto, a congressman I met with recently stated matter of factly that the EFCA is not going to go away. In fact, Hillary

Obama Edwards (our tripartite future President) has vowed to pass it.

*Peter A. List
Founder & CEO
Kulture LLC
Fairfield, N.J.*

» In an era when manufacturers, trying to meet the ever-lower price demands of Wal-Mart and other big-box stores, jettison their entire workforce and move production overseas, it’s patently nonsensical to blame unions for the collapse of U.S. industry. American businesses plot their own downturn when they sacrifice their workers: By cutting off employees from a source of steady income, they amputate their own consumers’ buying power. That, in turn, leads to demand for even lower prices (from the now unemployed workers), and the business declines even more.

If corporations truly perceived their workforce as the corporation—as the assets that allow it to invest in itself and continue to prosper—the resurgence of unionism wouldn’t be occurring. Yet because the execs in those corporations

look at workers as costs, they consider them expendable. The Welches would have corporations treat workers like livestock, thinning the herd whenever weather turns bad. If senior executives think the only way to make companies more efficient and more productive is with layoffs, automation, and offshoring, it’s time to send those perk-addicted self-preservationists back to B-school.

*Peter Altschuler
Santa Monica, Calif.*

» I enjoyed “The unemployment act” and agree with you on the danger to competitiveness. I also agree that the secret ballot is a critical component of democracy as it mitigates the probability of retribution. I have always wondered why the secret ballot was not applied to shareholder votes. I would be interested in your thoughts on why the secret ballot should not extend to proxy voting.

*Scott Newquist
West Palm Beach, Fla.*

» For a response to the Welches’ central contention that raising union



Pretty soon, if enough business leaders and legislators don’t stand up, it may well be: Hello again, unions. So long, American competitiveness

—from “The unemployment act”





piracy." These things, not labor unions, threaten our middle-class way of life.

*Richard A. Levins
Professor Emeritus of Applied Economics
University of Minnesota
Minneapolis*

» Thank you for expressing the urgency for business owners in this disastrous legislative effort. I am a management-side labor attorney who has been warning employers for months to pay attention and speak up.

*Seth Borden
New York*

» To blame the demands of union workers for the demise of some companies is a shot at the wrong target. Was it union demands or corporate greed that hurt or destroyed the likes of Enron, Worldcom, Adelphia, Tyco, and others? Were they union workers or company executives on perp parade in handcuffs?

*Fred Mussel
Emmaus, Pa.*

» Thank you Mr. Welch for the heads-up on this major proposed legislation. Its potential impact is enormous, yet this is the first I (and I'm sure many others) have heard of it. There should be open congressional hearings on this matter, with competent experts testifying.

*Paul D. Johnson
Bethesda, Md.*

» One problem with the Welches' Lehigh Valley example is that the decline of the American steel industry had more to do with cheap imports (and a strong dollar) than with the unions or the age of the plants. And steelmakers' wages are less important than the Welches might like to think. (The U.S. still imports more steel from the European Union than from China, for example.) Another problem is their assertion that the current election system works well. Alas, companies intimidate pro-union employees with ruthless abandon.

I would shrug off the wrong-headedness of this column if Mr. Welch did not have the stature in the business world that he does. Surely he remembers that when he was running General Electric, there were hundreds of thousands of unionized workers. Was GE hobbled by its union employees? Were they all freeloaders, demanding "two people for every job"? I think not.

*Tim Francis-Wright
Medford, Mass.*

Take a look at all the shuttered factories [of the Lehigh Valley]. Steel—like coal, autos, and so many other industries in the global economy—paid the inevitable price of unionization run amok.
—from *"The unemployment act"*

Our productivity has skyrocketed as we found continuously better ways to do things, vastly increasing the size of the proverbial pie. The pie is indeed very dynamic. Unfortunately, the view of unions is that the size of the pie is fixed, and it is just a question about how to divide it up. If unions had had their way 200 years ago, the vast majority of us would probably still be living in what today would be considered squalor.

*Chris Waldorf
Redmond, Wash.*

» The Welches should be worried about efforts to make unionization easier. The economy that so richly rewards them and a few others is one in which unions are much less of a force. The rest of us, however, need to remain concerned about "the twin deficits, low-cost Chinese manufacturing, and intellectual property

representation in this country from the current basement levels will cause mass unemployment, *BusinessWeek* readers need only look north. Card-check representation exists nationally in Canada, where the soup lines are not exactly overflowing.

*Chris Kutalik
Detroit*

I strongly agree with you, but I believe our future is dependent on the "core" of each individual American. And we have seen this core degrade on all levels. From the employee to the manager to the owner, we have seen more and more greed and selfishness. The proverbial "what is in it for me" scenario. Once we abandon this mindset, there will be revitalizing of America. But we may have to take a little bit of a beating first.

*Joel Watson
Fort Worth*

Hey Jack, we've got you scheduled to be in sewing machine #13 when you get to hell. By the way, that's in a nonunion shop.

*Ron Ritsema
Allegan, Mich.*

Ultimately, the wealth of a society is determined by its productivity. Over the past 200 years much of humanity has experienced increases in our standard of living and wealth well beyond the wildest dreams of what even kings could imagine. The reason:

Fitness as a Balance Sheet

Cycling is a challenge—and a stress reliever—for ex-hedge fund star Tiger Williams. **BY ADAM ASTON**

DAVID “TIGER” WILLIAMS is practically upside down, legs curled overhead, working out the kinks in his back before a hilly late-winter ride with his buddy George Hincapie. Even from this inglorious, if impressively limber, position, Williams is talking a mile a minute. He’s razzing George about being fat. Famous for assisting Lance Armstrong rack up seven Tour de France victories, Hincapie, 34, is now the Discovery Channel Pro Cycling Team’s most decorated U.S. rider and is at the peak of his own career. At 6 ft. 3 in. and 160 lb., Hincapie is hardly overweight. He has endless legs and a rail-thin torso, the quintessential cyclist’s physique. Williams, who just turned 45, does not. His frame is stockier, better suited for the hockey rinks he grew up playing on than any bike

race. (Williams got his nickname as a teen, when friends dubbed him Tiger after David James “Tiger” Williams, the NHL’s most penalized player ever.) Yet while maybe not a natural for cycling, Williams has taken to it with gusto.

He trains intensely, and when racing he is often among the top finishers in his age category. Williams’ commitment extends off-road, too. Along with Lance Armstrong and technology investment banker Thomas Weisel, he’s one of 15 co-owners of Team Discovery’s parent, Tailwind Sports, and a top fund-raiser for Livestrong.org, Armstrong’s cancer research foundation. “I’ve made some of my dearest friends and business associates through cycling,” he says.

When not in spandex, Williams is better known as the founder of Williams Trading and former head of U.S. equity trading at Tiger Management, Julian Robertson’s trailblazing hedge fund. With a staff full of ex-collegiate

and pro athletes, Williams’ firm provides white-glove trading services to hedge funds, family trusts, and other well-connected investors.

The business demands long hours and frequent travel. Cycling is his antidote to the physical and mental stresses that entails. Year-round, he maintains a 15-hour-a-week riding habit, racking up some 10,000 miles a year. At up to 1,000 calories per hour, the benefits are clear: “Fitness is like a balance sheet,” he says. “It’s calories in minus calories out. The more you ride, the more you can eat.”

Williams caught the cycling bug at 27 after knee surgery to correct a skiing injury. He was surprised to find that cycling offered the intensity he craved, with fewer aches and pains. In the ever-changing dynamics of the peloton—the main pack of riders in a race—he discovered that cycling poses endless tactical challenges along with adrenaline galore. “I enjoy it—especially racing—more as an intellectual ac-



Stretch Out Your Ride

Do each stretch three times or more before and after the ride, holding the position for a count of 30. If anything hurts, back off.

1 BACK

Lying on top of a hard foam roller, slide up and down so the roller moves along your spine. Focus on areas that feel tight.

2 LOWER BACK

Lying on your back, fully extend one leg, then pull the opposite knee up tightly into your chest. Reverse legs and repeat a few times before pulling both legs up to the chest and holding.

3 HIPS

Still on your back, bend one knee and rotate it across your torso so your body twists. Repeat with the other knee.

4 UPPER BACK

Lying flat with legs together and straight out, raise them over your head with feet behind you. The goal is to get your knees to touch the floor just above your shoulders.

5 HAMSTRINGS

Sitting with one leg straight, the other bent so the knee is flat on the ground and the foot is flush with the opposite thigh, lean forward and reach for toes. Reverse sides and repeat.

6 PELVIS

Sitting up with a straight back, spread your legs into a “V.” Lean forward, lowering your head and chest to the floor. With legs straight out, rock forward and backward so you feel the stretch in your back, hips, and hamstrings.

7 QUADS

Standing up, grab your right ankle with your right hand behind you. Gently pulling up and in toward your thigh, pull forward from the pelvis to stretch the quads. Repeat with the other leg.



tivity than a raw physical effort," he says.

Cycling's mellow side has its appeal, too. In recent years, Williams has entertained clients at the Amgen Tour of California. And he has ridden Tour de France routes with his girlfriend, Caroline Hildreth. "You can climb from lush green farmlands up to the moonscape pinnacles of Alpine peaks," he says, before watching Hincapie and teammates race the same route the following day.

LIFELONG PURSUIT

CYCLISTS DO RISK injury, of course, even if riding avoids the pounding of running and the hard hits of contact sports. Repetitive motion injuries, which can occur when muscles and tendons grow tight and inflexible from overuse, can strike a cyclist in the knees, hamstrings, or back. To avoid these, and manage old sports injuries to his back and knee, Williams aims to stay limber.

He recommends 15 minutes of stretching before and after a ride. To counteract the effects of being hunched over while pedaling, Williams focuses on his back, starting with a foam roller and a number of spine-bending moves. Then he does floor-based stretches to open up his hips, pelvis, quads, and hamstrings (table).

Following their heart-hammering ride, Williams is back in Hincapie's kitchen in Greenville, S.C., nibbling on rice crackers and guzzling Diet Cokes. With a nod to Ricardo Hincapie, George's 62-year-old dad—an ex-racer who spun comfortably through the morning's ride—Williams points out that few other aerobic sports can be done as intensely into old age.

It's America's youth, though, that worry him. Working with cycling devotee Robin Williams and Wal-Mart Stores Chairman Rob Walton, Tiger raises money for USA Cycling to help groom future pros and Olympians. He would like to set up training and racing programs for kids. "We're facing an epidemic of childhood diabetes and obesity," he notes. "What better way to reverse this tide and discover the next Armstrong?" ■



BusinessWeek .com

ONLINE: To see a slide show of Tiger Williams' workout, go to www.businessweek.com/extras



BY JONATHAN SCHWARTZ

A Passion for The Standards

THE AUDIENCE at the Algonquin Hotel's Oak Room, one of New York's premier cabarets, falls to silence when Maude Maggart starts to sing from the Great American Songbook. She becomes the words and respects the melody to the note. Richard Rodgers, Jerome Kern, Jimmy Van Heusen, and many of the other iconic composers who created these melodies would be proud. She is, note for note, a faithful messenger of the great stuff. ♪ Maggart's real name is Amber, but she chooses

Maude for the alliteration and because it's a name that evokes the era in which many of the songs she sings were written. At 32, she still looks like a girl. But the woman emerges on stage when she sings and, to a degree, when she speaks. For Maude Maggart, the songs are life itself, the reason for being alive, for falling in love, for risking everything with a man who has touched her heart.

Believe me, she has done her homework. She has learned by research and discipline and by channeling the wisdom of her guides, singers Andrea Marcovicci and Michael Feinstein.

Maggart has recorded four wonderful albums, but she is someone you must see perform in person. Her physical beauty, her brave presence, looking so vulnerable in front of the audience, is not captured on CDs. Her ethereal and frequently agonizing vibrato can be received by some as irritating on a disk, but for me the beauty of her singing overcomes the difficulties.

The songs she chooses are crafted with intelligence and talent. No false rhymes, like home and alone. Instead: "You are the promised kiss of springtime, that makes the lonely winter seem long/You are the breathless hush of evening, that trembles

on the brink of a lovely song."

That, by Oscar Hammerstein for a melody by Jerome Kern, is sung on the new *Live* album, which is drawn from performances at the Oak Room and the Gardenia, a cabaret venue in West Hollywood.

You should know something else about Maggart: Her sister, three years younger, is Fiona Apple, a contemporary singer/songwriter whose meta-

.....
MAUDE MAGGART
Live
SMAX PRODUCTIONS

phor-filled songs have reached a larger audience than Maggart's. "She is my closest friend," Maude told me. "She is my truest confidante."

The truest confidante, in her own song, speaks clearly, if often startlingly, of sexual freedom. Maude embraces the attitude but acknowledges that the women in the American Songbook often played women in submissive roles, roles that she rejects. Still, she sings those songs passionately, with abandon, and dresses provocatively to underscore her statement.

Two sisters, venturing forth with entirely different musical aspirations. Her unusual and interesting. Amber, as she is called by intimates, will carry her song all over the world. No nostalgist (despite her stage name), Maggart is a remarkable anomaly, making the standards seem as if they were written yesterday. Her audience is widening, pleased to receive the country's great musical gift to the world: the American Songbook.

Contemplate the words: "My favorite/Sweet comic valentine, make me smile with my heart/Your love are laughable, unphotographable, you're my favorite work of art."

Rodgers. Hart. Maggart.

Can you beat it? ■



MAGGART

Jonathan Schwartz hosts *High Standard* a channel on XM Satellite Radio, as well as weekend shows on WNYC-FM, a New York public radio station.



BY ROBERT PARKER

Old Aussie Vines, New Tricks

I**N THE EARLY 1990s**, David Powell of Torbreck Vintners discovered many old and neglected vineyards in Australia's Barossa Valley. While they yield less fruit than newer ones, the old vines produce more concentrated flavors. Powell helped growers nurse those vineyards back to health, and they now produce shiraz and grenache for Torbreck wines. Here are some of the current releases:

2005 Woodcutters Shiraz

95 points. Blackberry, raspberry, cherry, spice, and peppery aromas emanate from this full-bodied, opulent, voluptuously textured wine. Boasting superb purity, length, and intensity, this beauty simply delivers more than I expected. Woodcutters radically changes my opinion of what can be purchased for such a low price. It should drink well for seven to eight years. \$20

2005 Juveniles

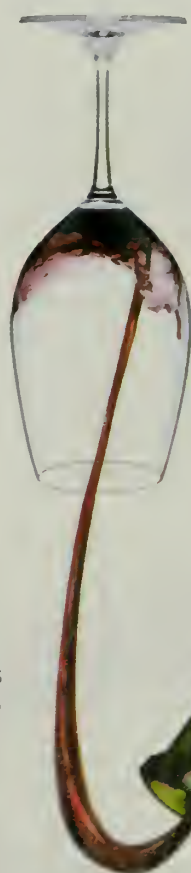
95 points. This tank-fermented and aged blend of grenache (60%), shiraz (20%), and mataro (20%) is made from 40- to 150-year-old vines. Provençal-like notes of pepper, rose, sweet cherries, and black currants leap from the glass. With superb fruit as well as purity and no hard edges, it can be enjoyed over the next two to four years. \$25

2004 The Steading

94 points. This Châteauneuf-du-Pape-styled wine is a blend (60% grenache, 20% Mourvèdre, and 20% shiraz) aged for 22 months in old wood. Its deep plum/ruby color is accompanied by a big, rich bouquet of resinous forest scents interwoven with kirsch, blackberries, pepper, and spice. Full-bodied, lively, heady, complex, and nuanced, it should drink well for 7 to 10 years. \$35

2004 The Struie

94 points. This 100% old-vine shiraz is an aromatic bouquet of blackberries and other sweet notes. It is a full-bodied, powerful, rich red with



great purity as well as focus, intensity, and a blockbuster finish that lasts nearly a minute. It will be even better with two to three more years of aging in the bottle and should last for two decades. \$50

2004 Descendant

98 points. This oak-aged blend of 92% shiraz and 8% viognier offers up notes of blackberries, ink, sweet truffles, and acacia flowers. There are 1,000 cases of this full-bodied, intense, rich blockbuster. It will drink well for 10 to 15 years. \$105

2003 RunRig

99 points. The grapes for the estate's flagship cuvée come from eight separate Barossa vineyards that range from 94 to 158 years old. This sensational inky, purple-tinged shiraz has a touch of viognier. It exhibits a sweet nose of blackberries, blueberries, lychee nuts, smoked meats, and a hint of apricots. Elegant yet superpowerful, rich, concentrated, and long, it is a tour de force in winemaking and should drink well for 20 or 25 years. \$225 ■

Robert Parker is the world's most influential wine critic. Visit eRobertParker.com to see tens of thousands of tasting notes, buy his books, or subscribe to his newsletter, *The Wine Advocate*.

Wines rated from 96–100 are extraordinary; 90–95, excellent; 80–89, above average to very good. For more Parker picks, go to businessweek.com/extras.

Winners Come in All Shapes and Sizes

Meet the champs of the 2007 Standard & Poor's/*BusinessWeek* Excellence in Fund Management Awards. **BY LAUREN YOUNG AND AARON PRESSMAN**

THERE ARE MORE THAN 6,000 mutual funds, but, hey, how many can you name? Chances are the ones you know are offered by giants such as Fidelity, T. Rowe Price, and Vanguard. The biggies have some fine funds, but excellence is not a matter of size. Scores of outstanding funds run by small investment management outfits fly below the radar. Ever heard of Keeley Small Cap Value? What about Kinetics Paradigm? They're both among our 24 winners of this year's Standard & Poor's/*BusinessWeek* Excellence in Fund Management Awards. "Year after year we unearth these tiny gems," says Phil Edwards, S&P's managing director of funds research. (Standard & Poor's, like *BusinessWeek*, is a unit of The McGraw-Hill Companies.)

To find our winners, we start with the 830 funds rated A or B+ in their categories for the five years ending on Dec. 31, 2006, in the *BusinessWeek* Mutual Fund Scoreboard (BW—Jan. 22). Our highest ratings don't necessarily go to the funds that racked up the biggest numbers. What counts are the risk-adjusted returns.

To be considered for the award, a fund must have assets of at least \$100 million, a manager with at least five years' tenure, and a minimum investment of less than \$26,000. It should also be open to new investors. Once a fund clears those hurdles, S&P analysts conduct in-depth, face-to-face interviews with managers to quiz them on investment practices.

In the four years since we started these

awards, our Best Managers have lived up to their billing. The average stock fund finalist beat the Standard & Poor's 500-stock index by 5.6 percentage points annually. (That's two years of gangbuster stock fund performance, and two years when our stock funds were within a hair's breadth of the index.) Among bonds, our finalists handily beat the Lehman Brothers Aggregate Bond Index in three of the four years.

On the pages that follow you'll discover the secrets that made four of the smaller fund companies successful and a chart of all 24 finalists. For more information on the other 20, plus a slide show, free S&P reports, and updates on our previous winners, go to businessweek.com/extras.



The S&P/
BusinessWeek
Annual
Awards



KEELEY SMALL CAP VALUE FUND

JOHN KEELEY JR., stockpicking more than a job. It's an obsession. "I have very few other interests, and I don't even consider it work," says the 66-year-old manager of the Keeley Small Cap Value Fund. "I intend to pass on to my eternal reward slumped over a Quotron terminal." Thirty years after starting his own research firm and 15 years after the launch of his mutual fund, Keeley remains as excited as ever about finding overlooked and underappreciated investments. During the past 10 years his fund has outperformed the Standard & Poor's 500-stock index by more than eight percentage points annually, on average.

Marketing isn't Keeley's forte, however, and his tiny business struggled for obscurity, despite his investment prowess. In 2002, almost 10 years after the fund opened, it had grown to just \$5 million in assets, so Keeley decided to bring in one of his sons who'd worked in marketing at a brokerage firm. A second son, also with marketing experience, joined in 2005. The young Keeleys started spreading the news, and made an extra effort to attend the trade shows that cater to investment advisers. Now the fund weighs in at \$1 billion.

Keeley gets his edge by shopping for stocks in the inefficient corners of the market, particularly spin-offs, restructurings, and companies emerging from bankruptcy. Wall Street typically doesn't follow such outfits or include them in indexes. So how does Keeley uncover these properties? "They're pretty much in the newspaper," he says. "But no one's doing a lot of analysis on them, so it's just a question of how hard



JOHN KEELEY JR.

you want to work on your own."

Look at Chaparral Steel, spun off from concrete company Texas Industries in 2005. At the time, the stock, with a book value of \$24, was trading for less than \$15. Now it's over \$50. "It didn't take a rocket scientist to figure out that

could be a good situation," Keeley says.

This spring will likely present a bevy



of opportunities for deep-value investors. That's because three big companies—Tyco International, American Standard, and Temple-Inland—are splitting up divisions and spinning them off to shareholders. Keeley should have plenty to keep him at his desk.

KINETICS PARADIGM FUND

UNLIKE SOME OF THE other smaller fund companies on our list, Kinetics Asset Management is no stranger to the limelight. Kinetics Internet Fund, which opened in 1996, was one of the first Web-oriented portfolios. The fund had a gripping story: Its young manager, Ryan Jacob, ran the business out of his mother's garage. Amid the tech run up, assets swelled to as high as \$1.5 billion as the portfolio gained 216% in 1999. Then the bubble burst, and the fund lost its luster.

All of the hype and subsequent bad publicity made Kinetics' co-founder Peter Doyle press-shy. In a recent and rare telephone interview from his Sleepy Hollow (N.Y.) office, he told *BusinessWeek*: "We have the reputation of being technology investors, but that is not who we are. We have done so many things right."

The first is performance. Kinetics Paradigm earned a 20.3% average annual return for the 2002-2006 period. That's nearly 15 percentage points better than the Standard & Poor's 500-stock index. (The Internet Fund, which has a new manager, gained an average 6.2% during the same period, while the firm's other three funds are outpacing their peers.)

Right now, Paradigm's \$2.8 billion portfolio, which has a wide berth to invest in large-, mid-, or small-cap stocks, is loaded with securities exchanges and other investment-related financial plays.

"If you believe stocks, bonds, and real estate are good investments...why not own the gateways and the gatekeepers?" says Doyle. The largest current holding is the NYSE Group, which owns the New York Stock Exchange and is unloved by Wall Street.

Kinetics' contrarian ways caught the eye of fund analysts at S&P. Doyle's anti-herd mentality helped him establish credibility with Dino Macaluso, a financial consultant in Albany, N.Y. During a sales pitch in late 2001, Doyle told Macaluso and his colleagues that Cisco Systems would soon trade in the single digits and other tech companies would experience a serious correction. "Most people in this business paint a happy scenario," Macaluso says. "The fact that Kinetics marches to a different beat is refreshing."

THORNBURG CORE GROWTH FUND

IT'S CALLED THE Thornburg Core Growth Fund, all right, but manager Alexander Motola has his own ideas about what constitutes a growth company. It's not just about buying companies with rocketing revenues and earnings. Indeed, some of the fund's top stocks, like DirectTV and Hertz Global Holdings, are just as likely to show up in the portfolios of value funds. "We have a pretty flexible approach to growth," says Motola. "To us, a growth stock is one that's promising but where there may be some material misperception about the company's earnings potential."

Actually, it's not that different from the approach of Legg Mason Value Trust manager Bill Miller (a five-time

winner of the fund manager award) in value investing, which includes stock like Amazon.com and eBay. Motola was attracted to Hertz, for example, when criticism about the company's quick return to being a public company after 2005 leveraged buyout distracted investors from the car rental giant's strong growth prospects. "This ownership extremely motivated now to move the stock price up," he says, noting that the LBO firms that took it private—Clayton Dubilier & Rice, The Carlyle Group and Merrill Lynch Global Private Equity—still own a significant chunk of the company's shares.

He's also willing to venture beyond U.S. borders. Shares of Copa Holding, which owns a Panamanian carrier called Copa Airlines, were languishing in the mid-20s last year on concerns about high fuel costs and a tricky takeover of Colombian competitor. But Motola says the company was able to maintain operating margins amidst the pressure. The stock has more than doubled since.

Motola's wide-ranging philosophy has rewarded shareholders with an average gain of 14% annually over the past five years, nearly double the average gain in the S&P 500. Thornburg is based in Santa Fe, N.M., far from

the daily grind of major financial centers. If the markets get too chaotic, Motola calms down by slipping out of his office. "When you can look up at an 8,000-foot peak, it's more conducive to keeping your sanity," he says.

Thornburg's assets under management just about doubled last year, to \$35 billion, but it's still a small company in the \$10 trillion fund industry. (



ALEX MOTOLA

Googling for Green Investors

Tiny companies such as Stratton Management (page 82) may not have a clue about promoting their funds. Then there's Fred Alger Management, which is taking a Web 2.0 approach.

Most of Alger's funds are sold through financial advisers, so the New York fund company was

not accustomed to dealing with do-it-yourself investors—the target audience for its new Spectra Green Fund, launched in January. Working with Google, Alger devised several hundred search terms that track Spectra Green's mission. Those include "green investing" and "global warming."

Google's auction process lets

advertisers buy the sponsored links that show up on the top and right side of the page. Costs can really vary: On some days a search word can cost as little as 10¢ or as high as \$65 per click.

What Alger quickly learned is that key words like "mutual fund" are too broad and pricey. The best bet is to keep search terms narrow—"alternative

fuels" delivered a high 12% click-through rate in mid-February. "The sweet spot is finding a word that is niche enough so that it doesn't burn a hole in your pocket, yet it says exactly what you are," says Alex Bernstein, Alger's vice-president of marketing. While Alger won't say how much it is spending with Google, the tab is expected to be seven figures. So far, the fund has brought in \$6 million from green investors. —Lauren Young



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PersonalFinance | The Best Fund Managers

advantage of their size is that there's no pressure to develop lots of new funds covering hot investment areas. "Every fund here is started by the investment department, not marketing," says Motola. That's why after 25 years, Thornburg runs only six stock funds.

STRATTON SMALL-CAP VALUE FUND

STRATTON Management, which runs the award-winning Stratton Small-Cap Value fund, is the smallest fund company on our list. Perhaps that's because marketing isn't a priority: The company's bare-bones Web site looks as if it were designed in 1996, a millennium ago in Internet time. "We are not proactive," concedes Gerald Van Horn, co-manager of the Stratton Small-Cap Value fund. "We have no marketing budget."

Indeed, when Robert Nelson, vice-

president at 1st Source in South Bend, Ind., was researching small-company funds for his clients a year ago, he called Stratton for information. Nelson expected to be zapped fund reports electronically, but some printouts arrived later via U.S. mail. "That really caught my eye—one one mails anything anymore," Nelson says.

Stratton's outreach methods are fusty, but the Plymouth Meeting (Pa.) fund's returns are anything but. The total return for the five years ended Dec. 31, 2006, is 16.7%. Stratton earns a place on the list, too, because it is still open to new investors. Many top small-cap value funds are closed.

With a relatively modest \$750 million in the small-cap portfolio, Van Horn



GERALD VAN HORN

says he has no trouble putting new money to work. With the help of computer screens—his investment methods are 21st century—Van Horn tries to identify unloved, undervalued stocks. Stratton's small size means more personal service, too. Have a question about a stock or strategy? Van Horn and the company's other

investment professionals actually talk shareholder calls. ■

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TELEVISION: For more on this year's award-winning fund managers, watch our weekly TV show, *BusinessWeek Weekend*.

In the Winner's Circle

FUND / SYMBOL	CATEGORY	MANAGER(S)	AVERAGE ANNUAL TOTAL RETURN**
AMERICAN CENTURY VISTA TWCVX	Mid-cap Growth	Glenn Fogle	9.2%
DODGE & COX INCOME* DODIX	Intermediate Bond (Gen.)	Team Managed	5.5
DODGE & COX INTL. STOCK DODFX	Foreign	Team Managed	20.8
EATON VANCE INCOME BOSTON A EVIBX	High-yield Bond	T. Huggins/M. Weilheimer	10.5
EATON VANCE NATL. MUNICIPALS A EANAX	Municipal National Long	Thomas Metzhold	8.9
FIDELITY SHORT-TERM BOND FSHBX	Short Bond (Gen.)	Andrew Dudley	3.8
FIRST AMERICAN REAL ESTATE A* FREAX	Real Estate	J. Wenker/J. Rosenberg	25.8
GOLDMAN SACHS HIGH YIELD A GSHAX	High-yield Bond	A. Jessop/D. Gordon/R. Cignarella	10.7
GROWTH FUND OF AMERICA A* AGTHX	Large-cap Growth	Team Managed	8.0
HARBOR BOND INSTITUTIONAL HABDX	Intermediate Bond (Gen.)	William Gross	5.5
JULIUS BAER TOTAL RETURN BJBGX	Intermediate Bond (Gen.)	R. Pell/D. Quigley	7.2
KEELEY SMALL CAP VALUE KSCVX	Small-cap Value	John Keeley Jr.	18.7
KINETICS PARADIGM WWPX	All Cap	P. Doyle/M. Stahl	20.4
LEGG MASON VALUE TRUST P* LMVTX	Large-cap Blend	W. Miller/M. Gay	7.8
MANAGERS BOND* MGFIX	Intermediate Bond (Gen.)	Daniel Fuss	7.4
METROPOLITAN WEST TOTAL RETURN M MWTRX	Intermediate Bond (Gen.)	T. Rivelle/S. Kane/L. Landmann	5.5
RS VALUE A RSVAX	Mid-cap Value	D. Kelley/A. Pilara Jr./J. Wolf	23.1
SSGA INTERNATIONAL STOCK SELECTION SSAIX	Foreign	C. Scholl/D. Rosenfeld	17.9
STRATTON SMALL-CAP VALUE STSCX	Small-cap Value	J. Stratton/G. Van Horn	16.7
T. ROWE PRICE GROWTH STOCK* PRGFX	Large-cap Growth	Robert Smith	6.2
TCW TOTAL RETURN BOND I* TGLMX	Intermediate Govt.	P. Barach/J. Gundlach	5.5
TEMPLETON GLOBAL BOND A* TPINX	International Bond	Michael Hasenstab	12.9
THORNBURG CORE GROWTH A THCGX	All Cap	Alex Motola	13.9
WESTCORE MIDCO GROWTH WTMGX	Mid-cap Growth	William Chester	8.9

* Previous winner **Appreciation plus reinvestment of dividends and capital gains before taxes Jan. 1, 2002-Dec. 31, 2006 Data: Standard & Poor's

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BY GENE G. MARCIAL

A THRIVING OIL PATCH MAY BOOST SALES FOR DRESSER-RAND GEAR.

ADVANCED LIFE SCIENCES HAS A PROMISING DRUG NEARLY READY

THE PENTAGON RELIES ON POWER FROM ULTRALIFE BATTERIES.

Bubbling Up at Dresser

WITH INFRASTRUCTURE SPENDING in the oil-and-gas industry starting to rise, Dresser-Rand Group (DRC), a leading maker of large compressors, turbines, and control systems, is catching the eye of investors. Its stock has spiraled from 18 in early October to 27.94 on Mar. 21. Dresser is benefiting from the large projects worldwide of major oil-and-gas companies, says Robert Starbuck of Schroder Investment Management, which owns shares. Its financials have been solid, but “the growth part of the story has yet to kick in,” says David Anderson of UBS, who has a “buy” rating. (UBS has done banking for Dresser.) Increased spending for floating platforms, refineries, pipelines, and liquefied natural gas plants, he adds, has boosted demand through the end of the decade. Compressors are “critical long-lead items” in refinery and upstream projects, and prices are starting to reflect this, says Ole Storer of Morgan Stanley, which has done banking for Dresser. He rates the stock “overweight,” with a 12-month target of 35. Storer projects earnings of \$1.67 a share for 2007, \$2.20 for 2008, and \$2.63 for 2009. CEO Vincent Volpe says many of Dresser’s clients have announced higher capital spending budgets for 2007. Dresser has alliances with such big clients as Marathon Oil, Shell Chemicals, ExxonMobil, and Chevron.



Advanced Life Sciences Is Advancing on Anthrax

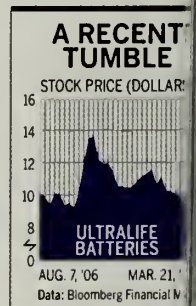
INVESTORS WHO STUCK with Advanced Life Sciences (ADLS) even after it delayed completion of Phase 3 clinical trials on cethromycin felt rewarded when the Food & Drug Administration granted it “Orphan Drug” designation. Such status is given to drugs that offer potential therapeutic value in treating rare diseases—those affecting fewer than 200,000 Americans—and grants it seven years of market exclusivity once approved. Cethromycin is a treatment for anthrax and “community acquired pneumonia.” Some analysts also stayed bullish despite the three-month delay. President John Flavin says the results will now be out in the second quarter. The delay was disappointing because it pushed back the filing for a new drug application, “but it’s a prudent approach” to get

the best study and results possible, says Angela Larson of Susquehanna Financial Group, who is “positive” on the stock. The trials started in December with 1,000 patients in 16 countries. The U.S. Army Medical Research Institute of Infectious Diseases is collaborating with Advanced Life on cethromycin. Ilya Kravets of Rodman & Renshaw rates the stock, now at 2.40, “outperform,” with a 12-month target of 5.



A Fresh Charge for Ultralife Batteries?

ULTRALIFE BATTERIES (ULBI) posted record sales in the fourth quarter, but it’s still in the red, partly because of a recent acquisition. Its stock has tumbled from 13 on Oct. 17 to 9.44 on Mar. 21. But that makes the stock more undervalued in the eyes of investment firm Grace Brothers, which has steadily been buying shares since last year, accumulating a 30% stake. Ultralife makes a line of lithium batteries that are used by various industries and military organizations worldwide. Ultralife’s lightweight and long-lasting BA-5390 supplies power for about 60 different devices used by the U.S. military and its allies in Afghanistan, Iraq, and elsewhere. About 50% of the company’s revenues in 2007 are expected to come from the Defense Dept. Grace’s strategy is to buy companies it figures are undervalued. Many of them end up being acquired. Grace declined comment. One fund manager close to Grace figures the stock is worth twice its price. Ultralife could be acquired, like other outfits Grace invested in, he says. Mark Grzymalski of Needham says Ultralife’s business remains solid and sees it earning 40¢ a share in 2007 on sales of \$120 million vs. year’s \$70.5 million. He rates it a buy, with a target of 14.



BusinessWeek .com

ONLINE: Gene Marcial’s Inside Wall Street is posted at businessweek.com/investor at 5 p.m. EST on the magazine’s publication day, usually Thursday.

Note: Unless otherwise noted, neither the sources cited in Inside Wall Street nor the firms hold positions in the stocks under discussion. Similarly, they have no investment banking or other financial relationships with them.



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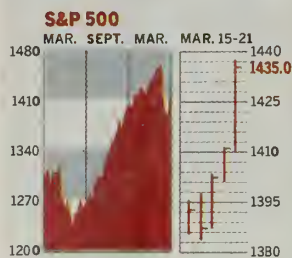


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STOCKS



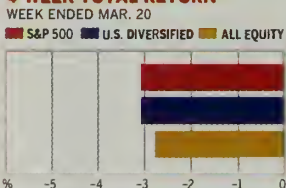
COMMENTARY

What a week: The market started rising in anticipation of positive news from the Federal Reserve, and then it took off after the Fed announced a more neutral position on monetary policy and held its target interest rate steady on Mar. 21. Private equity deals for Affiliate Computer Services and ServiceMaster also helped drive prices up.

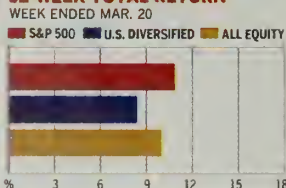
Data: Bloomberg Financial Markets, Reuters

MUTUAL FUNDS

4-WEEK TOTAL RETURN



52-WEEK TOTAL RETURN



Data: Standard & Poor's

U.S. MARKETS

	MAR. 21	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
S&P 500	1435.0	3.5	1.2	10.6
Dow Jones Industrials	12,447.5	2.6	-0.1	10.8
NASDAQ Composite	2455.9	3.5	1.7	7.0
S&P MidCap 400	851.5	3.5	5.9	9.8
S&P SmallCap 600	413.7	4.0	3.4	8.3
DJ Wilshire 5000	14,481.5	3.5	1.9	11.0

SECTORS

	MAR. 21	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
BusinessWeek 50*	811.5	3.6	1.6	5.9
BW Info Tech 100**	449.1	4.8	0.4	14.5
S&P/Citigroup Growth	656.2	3.1	0.6	7.1
S&P/Citigroup Value	777.8	3.8	1.8	14.2
S&P Energy	451.5	2.8	-0.9	14.9
S&P Financials	489.9	4.6	-1.1	11.0
S&P REIT	208.9	2.8	5.0	20.7
S&P Transportation	267.7	2.5	1.5	-1.7
S&P Utilities	201.7	4.3	8.1	26.5
GSTI Internet	204.8	4.0	2.6	8.9
PSE Technology	897.9	2.8	2.6	3.3

*March 19, 1999=1000 **February 7, 2000=1000

BEST-PERFORMING GROUPS

LAST MONTH %	LAST 12 MONTHS %
Tires & Rubber 17.0	Tires & Rubber 115.3
Gas Utilities 9.5	Divsfd. Metals & Mining 59.8
Power & Energy Traders 9.5	Steel 54.2
Oil & Gas Refining 7.0	Power & Energy Traders 42.9
Constr. & Engineering 6.2	Constr. Materials 40.3

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Utilities 1.2		Pacific/Asia ex-Japan 27.7	
Natural Resources 0.9		Utilities 27.5	
International Hybrid -1.5		Latin America 26.1	
Domestic Hybrid -1.6		Real Estate 23.0	
LAGGARS		LAGGARS	
Real Estate -5.9		Japan -1.1	
Financial -5.3		Health 0.1	
Latin America -4.9		Technology 3.0	
Health -4.2		Small-cap Growth 3.9	

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
DireXn. NASDAQ 100 Bear 2.5X 9.4		Dreyfus Prem. Grtr. China A 55.1	
DireXn. Sm. Cap Bear 2.5X 9.2		Old Mut. Clay Finlay Ch. A 49.0	
Rydex Dynamic Dow 30 H 8.3		E.I.I. Int. Property Instl 46.3	
ProFunds USh. Dow 30 Inv. 8.3		Oberweis China Opport. 46.3	
LAGGARS		LAGGARS	
iShares DJ U.S. Home Constr. -14.6		DireXn. Emrg. Mkts. Short -38.0	
SPDRS S&P Homebuilders ETF -11.6		DireXn. Dev. Mkts. Bear 2X -26.6	
ProFunds Real Est. Inv. -11.4		American Heritage Grth. -25.0	
ProFunds UltraEmrg. Mkts. -10.6		SPDRS S&P Homebuilders ETF -22.9	

GLOBAL MARKETS

	MAR. 21	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
S&P Euro Plus (U.S. Dollar)	2026.4	4.9	1.8	21.0
London (FT-SE 100)	6256.8	4.3	0.6	4.4
Paris (CAC 40)	5502.2	3.9	-0.7	6.6
Frankfurt (DAX)	6712.1	4.1	1.7	13.5
Tokyo (NIKKEI 225)	17,163.2	2.9	-0.4	3.2
Hong Kong (Hang Seng)	19,516.4	3.6	-2.2	22.1
Toronto (S&P/TSX Composite)	13,155.6	2.7	1.9	10.0
Mexico City (IPC)	28,219.6	5.6	6.7	44.0

FUNDAMENTALS

	MAR. 20	WEEK AGO	YEAR AGO
S&P 500 Dividend Yield	1.85%	1.86%	1.78%
S&P 500 P/E Ratio (Trailing 12 mos.)	17.2	16.7	18.1
S&P 500 P/E Ratio (Next 12 mos.)*	15.1	14.7	15.0
First Call Earnings Revision*	-0.24%	-0.41%	0.08%

*First Call

TECHNICAL INDICATORS

	MAR. 20	WEEK AGO	YEAR AGO
S&P 500 200-day average	1351.9	1348.9	Positive
Stocks above 200-day average	70.0%	63.0%	Neutral
Options: Put/call ratio	1.11	1.14	Positive
Insiders: Vickers NYSE Sell/buy ratio	6.39	6.72	Negative

WORST-PERFORMING GROUPS

LAST MONTH %	LAST 12 MONTHS %
Homebuilding -12.8	Homebuilding -2.0
Motorcycles -12.5	Distillers & Vintners -1.0
Automobiles -10.9	Electric Mfg. Svcs. -1.0
Distillers & Vintners -10.4	Photographic Products -1.0
Specialized REIT's -10.2	Airlines -1.0

INTEREST RATES

KEY RATES

	MAR. 21	WEEK AGO	YEAR AGO
Money Market Funds	4.86%	4.86%	4.86%
90-Day Treasury Bills	5.04	5.05	4.86%
2-Year Treasury Notes	4.53	4.55	4.86%
10-Year Treasury Notes	4.54	4.53	4.86%
30-Year Treasury Bonds	4.72	4.70	4.86%
30-Year Fixed Mortgage †	6.03	6.01	6.01%

† Bank of America

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND	30-YR. BOND
General Obligations	3.72%	4.00%
Taxable Equivalent	5.31	5.80
Insured Revenue Bonds	3.86	4.20
Taxable Equivalent	5.51	6.20

THE WEEK AHEAD

NEW HOME SALES Monday, Mar. 26, 10 a.m. EDT » New home sales probably inched up to an annual rate of 1 million units in February, after tumbling to a rate of 0.94 million in January, according to the median forecast of economists polled by Action Economics.

CONSUMER CONFIDENCE

Tuesday, Mar. 27, 10 a.m., EDT » The Conference Board's March consumer confidence index is

forecast to have pulled back to 108.5, after hitting a five-and-a-half year high of 112.5 in February.

DURABLE GOODS ORDERS Wednesday, Mar. 28, 8:30 a.m., EDT » February durable goods orders most likely rebounded somewhat, with a 3% increase. In January, there was a broad-based 8.7% plunge in orders.

PERSONAL INCOME Friday, Mar. 30, 8:30 a.m., EDT » Personal income probably made a modest gain of

0.3% in February, after a 1% jump in January. Consumer spending is expected to have climbed 0.4%, following a solid 0.5% increase in the previous month.

CONSTRUCTION SPENDING Friday, Mar. 30, 10 a.m. EDT » Building outlays in February probably registered a second straight monthly decline with a 0.5% fall. The contraction in spending will most likely be concentrated in the residential sector.

The BusinessWeek production index improved to 291.8 for the week ended Mar. 10, an 8.3% gain from year ago. Before calculation of the four-week moving average, the index held steady at 290.9.

BusinessWeek.com

For the BW50, more investor data, and the components of the production index visit www.businessweek.com/extras

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Invention Deficit Disorder

THE WIZARD OF MENLO PARK How Thomas Alva Edison Invented the Modern World

By Randall Stross; Crown; 376pp; \$24.95

Consolidated Edison, Commonwealth Edison, Southern California Edison: From the large number of corporate entities bearing the legendary inventor's name, one might deduce that Thomas Alva Edison became fabulously wealthy. Not so. In spite of his unrivaled fame, he was such a business failure that he once

contemplated giving up inventing and came to depend on large loans from his friend Henry Ford. A son, Thomas Jr., was provoked to bitter complaint: "You should have been... a millionaire 10 times over if you knew how to handle your own achievements."

The lack of monetary success was strongly linked to two Edison habits: First, he repeatedly refocused on new projects before older ones reached commercial fruition. Then, relentlessly pursued by admirers, the Dean of Inventors proved easily distracted by celebrity. "He was glad to hold forth on any topic, such as the relationship of diet to national destiny," writes biographer Randall Stross. "Pontificating on demand... came to supplant the actual work of inventing."

Edison's fame and how he managed it is a primary theme in Stross' *The Wizard of Menlo Park: How Thomas Alva Edison Invented the Modern World*. The inventor has inspired dozens of biographies, including Neil Baldwin's much lauded 1995 *Edison: Inventing the Century*. But the new book, written by a columnist for *The New York Times*, is both enjoyable and perceptive. Especially noteworthy is its debunking of Edison mythology and its focus on the inventor's true—and surprisingly limited—achievements and failure to capitalize fully on even those.

Stross passes quickly over Edison's youth, including his early work as a telegraph operator. A decision in 1869 at age 22 to become a full-time inventor led him to seek to improve Alexander Graham Bell's rudimentary telephone. And in 1877, while tinkering with the phone, Edison had the idea for one of his greatest inventions: the phonograph, initially little more than a needle soldered to a phone diaphragm and set up to transfer voice vibrations onto wax paper.

That year, a demonstration of an early version of the apparatus to the editors of *Scientific American* ignited a frenzy. "This was stop-the-presses news," says Stross, describing how the journal delayed publication so it could squeeze in an illustrated story on the gizmo. "Edison would never again

enjoy the sweetness of anonymous obscurity." Before long, was transformed into a "mythic inventor hero."

However, in what would become a pattern, the publicity created consumer demand that went unmet. "Edison simply could not muster the focus to complete [the phonograph's] development," and he allowed the effort to lie fallow for 10 years. He flitted from project to project, promising a revolutionary hearing aid, a giant megaphone, and finally, in 1878, a reliable, long-burning incandescent lightbulb. (Several designs for such lights already existed, but none worked well.) Once more employing a *coup de théâtre*, Edison

wowed members of the press with what Stross terms "sham demonstrations," briefly exhibiting far-from-perfect bulbs. The displays proved valuable as investor bait. In fact, Edison and his staff were a year away from developing a truly durable filament and three years away from commercial introduction of an electric light.

Over several years, his company labored to wire an entire Manhattan neighborhood. That project succeeded with a dramatic throwing of the switch in 1882. But there was no equally dramatic payoff: After a year, on 455 customers had signed up. Nor did Edison triumph with the phonograph, to which he returned in the late 1880s.

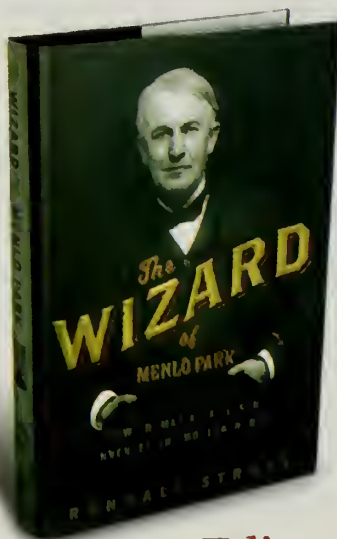
Edison's final noteworthy invention would be the kinetoscope, a motion picture machine he unveiled in 1891. It consisted of a wooden console with a peephole through which one viewed a very brief film. But the inventor saw

little commercial potential. In Stross' view, the workaholic Edison persistently failed to see "the limitless business opportunities made possible by the commercialization of fun." In the end, a projection machine invented by others and marketed under his name, "the one asset that he possessed that remained valuable."

Edison applied for his final patent in 1931, the year of his death, bringing his personal

total to 1,093. It was a seemingly vast accomplishment, even if most of the patents involved minor variations on previous ones. But his estate, first valued at \$12 million, was ultimately determined to be worth only \$1.5 million. (In contrast, Ford's net worth was estimated some years earlier at \$2 billion.) It wasn't chicken feed—but hardly the riches that might have been won by the Man Who Defeated Darkness. ■

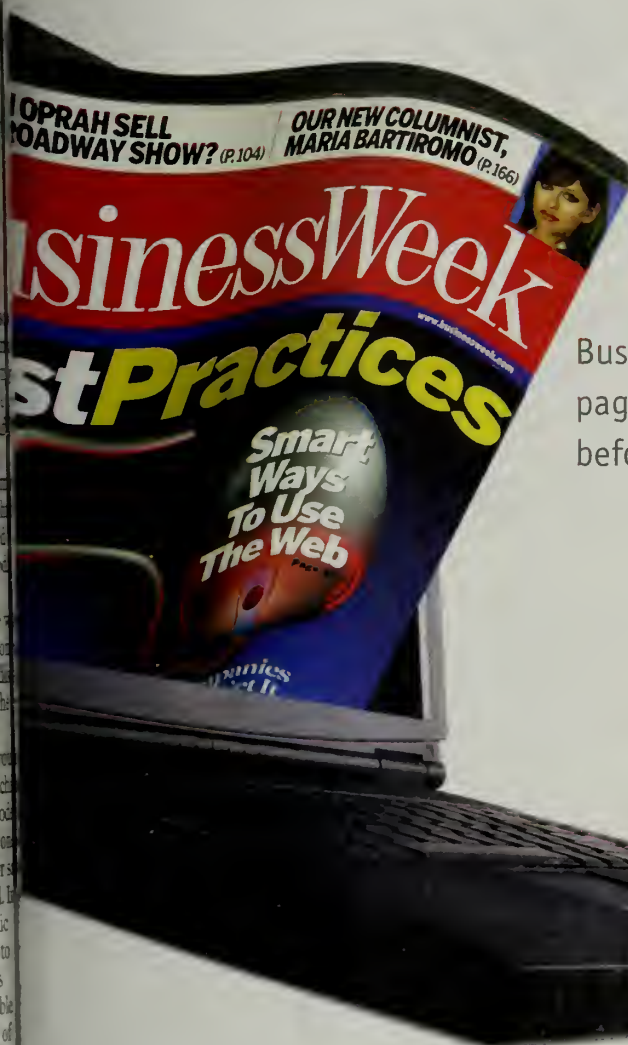
—By Hardy Grant



Edison flitted from project to project and often failed to capitalize on his inventions

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IdeasOutsideShot

BY JOHN K. CASTLE

Private Equity Paranoia

Some market commentators say the eye-catching growth of the private equity business may have oversaturated U.S. capital markets, potentially harming investors and increasing the risk of business failures, which could trigger a recession. Various reasons are offered for these woeful predictions. One is that intense demand from buyout funds may push equity prices to

unsustainable levels, which could result in a collapse that would adversely affect pension funds, foundations, and academic endowments, as well as individual investors. Others worry that shifting huge portions of the corporate landscape into private hands, loading formerly strong companies with excess debt, heightens the risk that those companies will fail. Yet another fear is the destruction of shareholder value, as buyout funds team with corporate management to take companies private, reaping large payouts at the expense of the former public shareholders.

I think that gloom-and-doom scenario is dead wrong, and that the private equity business still has plenty of room to grow without upending our economy. True, private equity investment has grown dramatically, even exponentially, over the last five years. Blackstone Group raised \$15.6 billion last year, then added \$5 billion through a rights offering this year. Texas Pacific Group raised \$15.2 billion in 2006, while Apollo Management and Bain Capital raised \$10.1 billion and \$10 billion, respectively.

BLACKSTONE'S RECENT \$39 BILLION acquisition of Equity Office Properties Trust showed that few deals are too large for this new breed of investor. Now if reports that Blackstone—which made its name taking public companies private—is planning to take itself public prove true, few could deny that private equity is primed to become a fixture of the financial landscape. Yet while the sums amassed by private equity players aren't inconsequential, they don't signal an industry out of control. Nor do they tell the whole story.

U.S. private equity firms raised a record \$215.4 billion in 2006, according to the Dow Jones *Private Equity Analyst* newsletter. Since 2000, private equity investors—mainly pension funds, endowments, and other institutional investors, along with some individuals—have committed \$555 billion to private equity funds, with \$322 billion of it still to be invested, according to Wachovia Securities. But the numbers, big as they are, must be kept in perspective.

Views expressed in Outside Shot are solely those of contributors.

Forget the gloomy predictions. The market still has plenty of room to grow

For example, that \$322 billion in private equity capital is just slightly more than the equity market capitalization of Microsoft (\$302 billion) and less than that of ExxonMobil (\$425 billion) and General Electric (\$379 billion). Of course private equity funds typically leverage their equity capital with debt, so the total purchasing power of private equity's \$322 billion might be as much as \$800 billion. That roughly equals the total enterprise value—market equity capitalization plus debt, minus cash—of GE (\$748 billion) and ahead of No. 2 Citigroup (\$698 billion). In other words, the private equity business has about the same economic muscle as GE's Jeff Immelt or Citi's Chuck Prince.

Indeed, the \$322 billion in private equity is equivalent to about 1.6% of the \$20.1 trillion in total equity value of all the companies traded on the principal U.S. exchanges. Private equity's piece of the pie is even smaller measured against the \$54.1 trillion net worth of U.S. households and nonprofit organizations—the individuals and entities that ultimately own all financial, real estate, and other assets. While not exactly chump change, the buying power of available private equity money pales by comparison.

Private equity acquisition prices have indeed increased as the economy recovered from recession, rising from 6.1 times EBITDA (earnings before interest, taxes, depreciation, and amortization: a common measure of underlying earning power) in 2001 to 8.6 times in 2006 for large deals. Debt financing has made up most of the difference with equity's share modestly declining. But acquisition multiples paid by public companies remain higher than those paid by private equity acquirers, frequently exceeding 10 times EBITDA in such deals as Express Scripts' acquisition of Caremark Rx (13.2 times). This certainly doesn't suggest that private equity funds are overpaying, nor that growth in private equity is propelling valuations generally to unsustainable levels. Instead I believe private equity can profitably—and safely—expand for many years to come. ■

John K. Castle is chairman and chief executive of Castle Harlan Inc., a private equity firm.

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Ideas **The Welch Way**

BY JACK AND SUZY WELCH

Fear of Flying High

My problem may not seem like a problem to you, but it has me completely panicked. My last project was considered a "huge" success, and as a result I was promoted up three rungs to run a department. I know I don't have the experience or the knowledge to be doing this job. What should I do?

—Anonymous, Hartford

You're right, we don't often get letters from people who are worried about rising too fast. In fact, the vast majority of job-related laments we receive are from people bursting with frustration over the sloth-like pace of their ascent. But don't take that to mean you're alone. Hardly! There isn't a good manager in the world—even one who has been in the job for years—who doesn't have a daily panic attack about the load of stuff he doesn't know but should, the confounding challenges ahead, and the sheer impossibility of getting it all done.

So, congratulations. You've stumbled upon one of the best-kept secrets about work. Getting promoted is a double-edged sword: thrilling, yes, but terrifying. Everyone is calling you with hearty congratulations and slapping your back, saying you deserved it. And you're smiling away and thanking them, but inside you're feeling a lot less jovial than you look. It doesn't matter whether it's your first managerial stint or the culmination of your career, with a seat in the corner office. You are the only one who understands how little you actually know about the new job, especially when compared with those big, bold expectations your bosses keep mentioning. Whatever happened, you want to scream, to the perfectly logical idea of a grace period?

You don't scream, of course. After all, you've been told that leaders need to appear calm and in control, and that's true. Leaders should look and act like leaders for the sake of their people's respect and confidence and the organization's momentum. But being a leader doesn't mean you can't ask questions; good leaders are, by definition, voracious learners, relentlessly probing the people around them for ideas and insight. They are voracious relationship builders, too, really getting to know everyone in the business who can open their eyes to the "who, what, and when" of the job. Obviously, you don't ever want to seem clueless, and we can't imagine you would, given your past success. You want to appear deeply inquisitive about every aspect of your business and passionate about what your people think it will take to win. Those traits won't

undermine your authority. They'll enlarge it.

Are we asking you to fake it? No—we're asking you to reinvent your self-perception according to reality. Right now you feel like virtually every new leader. Do you think that a President feels anything different making the leap from, say, running a little Southern state to having his finger on the nuclear trigger? Being in charge of something new starts the game all over again, no matter what you've done before.

Take your case. You're probably looking around at your team and wondering: "When will they realize I just had one little project that went well?" You're probably sitting in meetings listening to rapid-fire conversation about products and customers that are filled with so many new names and buzzwords that they might as well be in Urdu. You're probably reading e-mails from your boss about the next quarter's results, and you don't even know your current cash flow yet.

ALL THIS MAY MAKE you want to dub yourself "not ready." We're saying, dub yourself "normal." Sure, you will eventually come to know more about your job. There will

even be days—say, six months or a year from now—when you feel on top of it all. But business today changes too fast and has too many variables for any manager to ever have the sustained sense of security you yearn for. Indeed, part of being a leader circa 2007 is being able to live with an uh-oh feeling in your stomach all the time.

Don't let that panic you more. Instead, consider the proposition that continually feeling a bit overwhelmed and underinformed is a positive thing, for both you and your business. Everyone knows that too much confidence can lead to arrogance and a kind of "that's how we do it around here" inertia. The flip side is an insatiable hunger for new ideas

and better ways to do things—a hunger that makes you fight like hell to win.

Look, we're not telling you to enjoy yourself right now. Having walked in your shoes, we feel your knees knocking. But don't turn and run. Make peace with your panic. It goes with the job. ■

Jack and Suzy Welch look forward to answering your questions about business, company, or career challenges. Please e-mail them at thewelchway@businessweek.com. For their weekly podcast go to www.businessweek.com/search/podcasting.htm.

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The #1 killer of teenagers *doesn't have a trigger.*



IT HAS A STEERING WHEEL.



Motor vehicle crashes are the #1 cause of death for teens in America. They take nearly 6,000 lives and injure another 300,000 every year. Those numbers remain unacceptably high, despite safer cars, better roads and decades of safe-driving programs. We think it's time for a change.

So The Allstate Foundation has developed a new, nationwide program: "Keep the Drive." It mobilizes teens to become safe-driving activists by involving them in designing a new safe-driving program. And it uses the power of peer influence to help teens think and act smarter every time they get into a car — as a driver or a passenger.

Peers are some of the most important influences in getting teens to drive more safely. "Keep the Drive"

can help them realize that **smart driving is the key to keeping their licenses, their cars, their friends and their futures.**

To learn more about this issue and what you can do to help, go to Allstate.com/community

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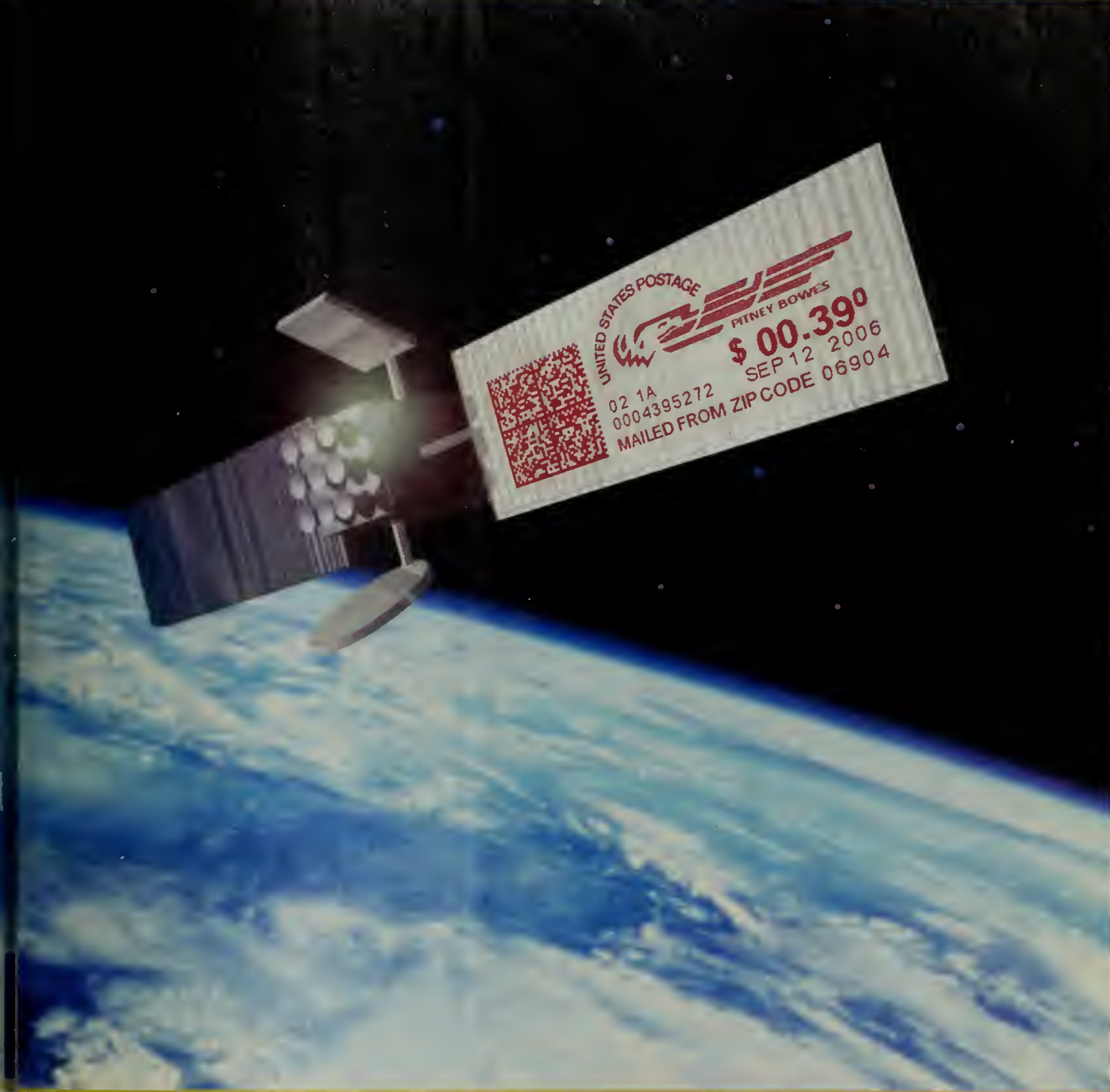
A satellite view of Earth from space, showing a vast expanse of blue oceans and white clouds. A large, swirling hurricane is visible in the lower right quadrant. The horizon of the Earth is visible against the black background of space.

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downside surprise in new-home
s; Citi considers massive layoffs;
s big fat fine for technology transfers

News & Insights

Wanted: Bulgarian Programmers

R companies flood Central Europe,
ed workers are in short supply

Beazer's Lending Under Scrutiny

eral investigators are looking into
homebuilder's mortgage practices—
unusually high foreclosure rate

Making MySpace a Money-Spinner

high-traffic social-networking site
yet to generate much ad revenue, but
s Corp. has plans to change that

Commentary: Motorola

Icahn's demands aside, the
ronics giant needs to spend on
vation—not just stock buybacks

Oracle's Legal Uppercut

y Ellison's high-profile suit against
SAP may be nothing more than PR,
that may be all he's after

Global Business

Russia's New Deal

Kremlin is pumping money into
ration, housing, and health care,
gh critics say it's just for the votes

Zen and the Art of Selling Minimalism

artment store Muji is set to bring its
ped-down chic to America

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Asian business, please go to
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Economics

Business Outlook

Cooper says slack capital spending
re real threat to the economy; credit
debt goes through the roof

BusinessWeek (ISSN 0007-7135) Issue number 4029, published
except for one week in January, July and August by The
Hill Companies, Inc. Executive, Editorial, Circulation and
ing Offices: 1221 Avenue of the Americas, New York, N.Y.
Periodicals postage paid at New York, N.Y. and at addit onal
offices. Canada Post Publication Mail Agreement Number
01. Return undeliverable Canadian addresses to: DPGM Ltd.
Bath Road, Mississauga, ON L4T 1L2. Email: bwcustserv@hill.com
ster: Send address changes to BusinessWeek, P.O. Box 8418
rt, IA 51591-1418



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51 How the Boss Sees It CEO Eric Schmidt says Google has no lock on its huge popularity, which could vanish “in a nanosecond”



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TAKES
VISA

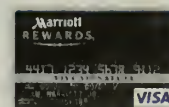
Things to do while you're alive:

- Learn to fly-fish at Inverlochy Castle
- Visit an uninhabited island
- Celebrate St. Patty's Day in Dublin
- Run with the bulls in Pamplona
- See the Leaning Tower of Pisa
- Camp on Seven Mile Beach
- Eat an insect
- Win a karaoke contest
- Write a screenplay
- Climb an eightener
- Watch a space shuttle launch
- Travel with handmade fitted luggage
- Drink a margarita on Isla Margarita
- Find the Big Dipper
- See a penguin in its natural habitat
- Look down from the Cliffs of Moher
- Take your parents on a vacation
- Shoot a hole in one
- Deep-sea fish and eat your catch
- Attend the Argentine Polo Championships

Have a museum all to yourself

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The MacAskill family, a.k.a. the SmugMug team

Keeping It All in the Family

For family businesses, succession is always an issue. But with the nation's 77 million baby boomers edging toward retirement, family businesses are confronting a major demographic shift, and the largest generation in history is preparing to hand over responsibility to the kids. That's the focus of our **BusinessWeek.com Special Report on Family-Owned Business**. Some ventures are adapting to suit the needs of the younger generation. Others are teaching the kids to pitch in from Day One. Take a look at our **slide show** for a tour of Simple Times Farm in Grand Blanc, Mich., where life isn't so simple but the seven-person family is persevering and relishing the lifestyle. Also, go behind the scenes to find out what **Martin Guitar's CEO is planning, even though his heir apparent is still in diapers**. Or get a glimpse of the family behind the profitable photo-sharing site SmugMug. This clan is turning **the traditional family-business hierarchy upside down**. Finally, tune in to a podcast with Don Schwerzler, founder of the Family Business Institute, who talks about marrying innovation with succession planning. Go to www.businessweek.com/go/07/family for all this and more.

BusinessWeek weekend

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"Living Room." Park Güell, Barcelona
Image courtesy of the human network.

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On the human network, people everywhere are experiencing a new kind of day. Encyclopedias update themselves every minute. Movies appear wherever there's a screen handy. And a phone can double as a train ticket or a lift ticket. Welcome to a place where wikis, collaborative applications and social networks are making us smarter, better and faster. Welcome to a network where anything is possible. Because when we're together, we're more powerful than we could ever be apart. The story continues at cisco.com/humannetwork.

welcome to
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WHAT YOU KNOW

WHO YOU KNOW

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SOME IS NOT.

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"To paraphrase Mark Twain, the rumors of Vonage's death have been greatly exaggerated."

-Vonage CEO Mike Snyder in a statement issued by the company after its stock price plummeted in the wake of Verizon's patent infringement victory against it.

EDITED BY ERIC SCHINE

CAR TALK

GM's Big Move to Small Chevrolets

THERE'S SOMETHING you don't often hear from **General Motors**: Small is cool. Yet that'll be GM's pitch Apr. 4 when the automaker takes the wraps off a trio of subcompact cars at the New York Auto Show. These Mini Cooper-size cars are also likely to carry mini prices—less than \$10,000. GM's Chevrolet unit is out to prove that its diminutive cars, called the Trax, the Beat, and the Groove, can be as stylish, fuel-efficient, and playful as any Honda or Toyota. Chevy also wants to show that its brand stands for more than just gas-guzzling monsters like its Suburban SUVs. Says John Smith, GM's group vice-president for global strategy: "It's time to do something more with cars."

These little guys are still concept cars. While they could be sold overseas around 2010, Smith says GM will decide whether to offer them in the U.S., based in part on reaction at the New York show. GM designed the cars in Korea, where engineering costs are 30% lower than in the U.S., and would build them in low-cost emerging-market factories.

To refocus buyers, GM is ramping up an ad campaign with the line,



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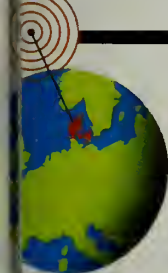
"People Who Love Cars Love Chevrolet." While GM will still hype its trucks with country music ads, it has also cut a

marketing deal with young rap musician T.I. to reach a more hip-hop crowd.

GM isn't the only U.S. automaker eyeing the small-car market. **Daimler-Chrysler's** Smart Div. plans to launch a minicar in the U.S. next year, and **Ford** will bring a new subcompact to the U.S. in two years. Still, Detroit's

experience with small cars is a sorry tale. Remember the AMC Gremlin and Ford Pinto? "Bringing a car that size to the U.S. as a commodity is suicide," says James Hall, vice-president at research firm AutoPacific. "They have to be image cars like Mini and Scion."

To help GM gauge whether its cars will make the grade, consumers can soon vote for their favorite mini at www.vote4chevrolet.com. With enough interest, these little Chevys could be rolling in the U.S. of A. *-David Welch*



THE BIG PICTURE LOOK WHO'S WIRED FOR GROWTH

OLD EUROPE? Not when it comes to tech. Europe blew away the U.S. and Asia in the **World Economic Forum's** sixth annual Networked Readiness Index. The just-out 2006 results ranked 122 countries on their ability to make use of info tech to promote economic growth. Denmark came in first, climbing from third place in 2005 and bumping the U.S. from its top post all the way down to seventh place. China was buried in the pack, falling from 50th to 59th place. Here are the top 10 nations:

1	3*	2	8	2	5	9	12	7	1	8	4	9	10	10	13				
Denmark		Sweden		Singapore		Finland		Switzerland		Netherlands		U.S.		Iceland		Britain		Norway	

*5 rankings Data: Networked Readiness Index from the Global Information Technology Report, World Economic Forum in cooperation with INSEAD. 67 variables examined

REALTY CHECK



BLEAK HOUSING NEWS

Here's another reason to get antsy about real estate. Banks and investors in the mortgage-backed securities industry are increasingly worried that the troubles in the subprime market will spread to higher-quality home loans. In a survey of expected attendees at the upcoming **Spring ABS Show** (for asset backed securitization), some 87% of respondents said recent subprime woes would have at least a "partial impact" on the performance of the broader market for mortgages and mortgage-backed securities.

More than 50% of the loan issuers and mortgage investors surveyed expect the ABX index, a benchmark for subprime performance, will trend lower in April. Adding to the pessimism, about two-thirds say they don't view the current sell-off as a buying opportunity, and about three-quarters said they expect median home prices to decline for the rest of the year. About half felt proposals to tighten subprime lending standards could help shore up the market. —Elizabeth Woyke

HIGH-TECH TIPPLE

BORDEAUX GOES TO THE LAB

WINE EXPORTS from France's Bordeaux region ended a five-year decline in 2006, growing 23%, to \$1.5 billion. But not all that wine tastes like classic Bordeaux. To counter the rise of New World wines, many of the region's 6,000 producers are abandoning age-old production methods. Now they send samples to labs that analyze everything from alcohol and sugar content to trace elements such as iron and calcium.

Armed with such data, oenologists help growers adjust flavors to today's tastes. "The wine being made in Bordeaux now is nothing like the wine that was made 20 years ago," says one of those chemists, Jean-Philippe Gervais.

The idea is to make wine that's lighter and fruitier than earthy Bordeaux. "It used to be the client who adapted to Bordeaux. Now, it's the reverse," says Marc Lurton, whose **Château Reynier** has nearly doubled exports since 2000 by introducing new blends sold mainly in the U.S. and Britain. Working with the region's **Grézillac Oenological Center**, Lurton has changed the way he grows grapes. He lets vines grow taller so grapes get more sun, increasing their sugar content. And he heats his grapes briefly before crushing them, for what he calls a "rounder" flavor. —Carol Matlack



IMPORT/EXPORT

SMOG ACROSS THE WATERS

WORLD TRADE gets the blame for all sorts of ills, from the loss of well-paying factory jobs in the U.S. to the rise of sweatshops in China and other developing nations. Now add global warming to the list.

The more than 90,000 commercial vessels crisscrossing the oceans produce more carbon dioxide than all but 10 of the 39 industrialized nations originally included in the Kyoto Protocol, says a study by the **International Council on Clean Transportation**. That includes the Netherlands, Poland, and Spain. This massive global flotilla also emits more sulfur dioxide than all the cars, trucks, and

buses on the planet, and a sixth of all the nitrogen oxide pumped into the atmosphere, says the study.

The outsize emissions at sea reflect the limitations of world politics. While national governments have forced giant reductions in discharges from vehicles and smokestacks, the **U.N.'s International Maritime Organization** has maintained looser limits on ships, in part because 139 countries are

involved in crafting controls. Some fuel burned in ships, for instance, contains 27,000 parts per million of sulfur on average. In the U.S., diesel fuel cannot have more than 15 parts per million. The IMO plans to take up no pollution standards at a midsummer meeting.

—Michael Arna



SEA SMOKE
Ships spew clouds of CO₂

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ECO TRENDS

ENGLAND'S GREENER AND PLEASANT LAND

THINK OF THEM as personal eco-trainers. So-called carbon coaches are helping Britons who want to learn how to live greener. For a fee of \$300 to \$600, advisers assess a family's energy usage and recommend ways to reduce it—everything from adding insulation and using halogen bulbs to installing a rooftop system to recycle rainwater.

Business is booming for the dozen or so green advisers, most of them based in the south of England, where they largely serve cash-rich, time-strapped customers. "I've had so



many calls from interested clients I haven't even had to do any marketing," says Donnachadh McCarthy, founder of London's **3 Acorns Eco-Auditing** and author of *Saving the Planet Without Costing the Earth*. McCarthy, who says he conducts at least two home

audits a week, is also getting requests from companies.

Green coaching is about to get a boost from London Mayor Ken Livingstone's **Green Homes** program, which will roll out later this year across the capital as part of a wider initiative to combat climate change. The new service, announced on Feb. 28, will sell home energy makeover tips to Londoners for about \$400 a session. There seems to be more than enough eco-demand to go around. Former engineer Dave Hampton, who runs **Carbon Coach**, based in the Thames-side town of Marlow, is planning to set up a side business in training others for the trade. —Kerry Capell

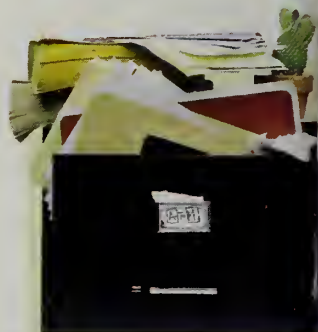
BOOMER ANGST

MORE ACHES AND PAINS FOR THE OVER-50s

BABY BOOMERS creeping up to retirement age think they are in poorer health than their counterparts viewed themselves 12 years earlier, according to a new study. The boomers surveyed, aged 51 to 56 in 2004, reported that they were having more difficulty with a range of everyday physical tasks than did the earlier group, as well as more pain, chronic ailments, and psychiatric problems.

Only half of those in the 2004 group rated their health as "excellent" or "very good." By contrast, in the 1992 survey, 57% reported above-average or excellent health. The findings, published by the **National Bureau of Economic Research**, are from a continuing study that intends to survey 20,000 people every two years through mid-century.

Lead author Beth J. Soldo, director of the **University of Pennsylvania's** Population Aging Research Center, says the results run counter to the conventional wisdom that the Baby Boom generation, born between 1946 and 1964, would retire in robust health. One big factor: high rates of obesity in the U.S. Still, the results may be skewed by the unrealistic view some boomers hold of their aging bodies. Says Soldo: "Once their health falls short of expectations, they take notice." —Catherine Arnst



OFFICE LIFE

WANTED: A CLUTTER CUTTER

WORKERS in cramped cubicles aren't the only ones making do with less in the corporate world. A survey by office furniture maker **Steelcase** found that 30% of white-collar workers still have private offices, but even for them, the four walls are closing in. The poll of 9,300 workers revealed that the typical private office has shrunk from 16 by 20 feet a few years ago to a more common 8 by 10 today.

Has that brought about better organization of space? Hardly. The study found that most of us make our offices even more cramped by piling papers, rather than filing them. Our drawers and cabinets store snacks, shoes, or nothing at all. Sound familiar?

Better design could come to the rescue. Steelcase thinks today's smaller offices would benefit from dual-purpose furniture—a file cabinet-chair combo on wheels, for instance. Extra outlets for laptop-wielding visitors would also help, as would bigger work surfaces that give people more options for personalizing their space. —Elizabeth Woyk

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HONDA
The Power of Dreams

ANALYZE THIS

BY KERRY J. SULKOWICZ, M.D.

The Psychology of the Deal

I work in the investment business and want to understand more about the psychology of making deals. I notice that even seasoned negotiators, who have a knack for figuring out what makes a person tick, sometimes get it wrong. Can someone with psychological training analyze a target at a distance to provide an edge in talks?

—A.G. Newmyer III,
Palm Beach Gardens, Fla.

THE ANSWER, in my view, is yes. My colleagues and I have been helping clients develop psychological profiles of executives involved in high-stakes mergers-and-acquisitions talks and other negotiations for many years. We find that having an understanding of the mind of the person sitting across the table can make all the difference.

Business talks are essentially psychological processes. Nobody ever says yes to the first offer. Why? Not just because it's bad business but because to do so would show weakness and submission, intolerable feelings for most people. When seasoned negotiators "get it wrong," it's often because they've miscalculated the other party's emotional attachment to what they're giving

up, whether that's something they own or money itself. Or they assume their approach will lower the other party's resistance to saying yes, when in fact it increases it.

Applying dynamic insights, provided at a distance by a trained clinician, can unlock even the thorniest of business interactions. An analogous situation is that of a patient who describes his wife to his psychoanalyst. The analyst may never meet the wife, but as the analyst speaks with the husband, they jointly develop an understanding of what makes the wife tick, and this, in turn, can help the husband relate to her better.

Now substitute CEO A for the husband and CEO B (the potential acquiree) for the wife. CEO A has various interactions with CEO B in meetings, at industry events, on the golf course, or through phone and e-mail contact. In discussing those interactions with me, we can figure out how CEO A can better size up CEO B. The psychological portrait that emerges, while

inevitably imperfect, is often good enough to make a difference in negotiations.

Your question touches on an interesting controversy: Psychiatrists got into trouble when one of them made a damning diagnosis from afar of Barry Goldwater during the 1964 Presidential race, deeming him unfit for office because of what was considered his paranoid behavior. The subsequent backlash caused

the pendulum to swing too far in the other direction, with shrinks avoiding such bold pronouncements ever since.

That's too bad. A psychoanalytic assessment, even of someone you've never met, has a

positive role to play not just in personal life but also in business dealings and even in helping to choose a President.

Kerry J. Sulkowicz, M.D., a psychoanalyst and founder of the Boswell Group, advises executives on psychological aspects of business. Send him questions at analyzethis@businessweek.com



QUESTION OF THE WEEK

Do people really want to watch TV on their cell phones or other handheld devices?

"In doctors' offices, buses, cars, or waiting in line, mobile media is the perfect solution. People will pay not to be bored out of their skulls. So the content is more valuable to producers there than on traditional Internet delivery."

Mark Cuban, president and of HDNet



"I'm convinced some people would marry their cell phones if they could, so TV is just the next logical extension. Still the majority will—or should—shun this innovation. Diminished screen, diminished returns."

Matt Roush, television critic, TV Guide



"People will pay for access. The appetite for media is growing exponentially, and that means it will be consumed on multiple screens at times and places the industry never thought of reaching the consumer."

Jason Hirschhorn, president, Sling Media Entertainment Group



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Find out how to improve your sleep habits at www.lunesta.com. Or call 1-800-Lunesta.

IMPORTANT SAFETY INFORMATION: LUNESTA works quickly, and should be taken right before bed. Be sure you have at least 7 hours to devote to sleep before becoming active. Until you know how you'll react to prescription LUNESTA, you should not drive or operate machinery. Do not use alcohol while taking LUNESTA. Most sleep medicines carry some risk of dependency. Side effects may include unpleasant taste, headache, drowsiness and dizziness. See important patient information on the next page.

Lunesta
(eszopiclone)
1, 2 AND 3 MG TABLETS

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Lunesta[™]

(eszopiclone)
1, 2 AND 3 MG TABLETS

Please read this summary of information about LUNESTA before you talk to your doctor or start using LUNESTA. It is not meant to take the place of your doctor's instructions. If you have any questions about LUNESTA tablets, be sure to ask your doctor or pharmacist.

LUNESTA is used to treat different types of sleep problems, such as difficulty in falling asleep, difficulty in maintaining sleep during the night, and waking up too early in the morning. Most people with insomnia have more than one of these problems. You should take LUNESTA immediately before going to bed because of the risk of falling.

LUNESTA belongs to a group of medicines known as "hypnotics" or, simply, sleep medicines. There are many different sleep medicines available to help people sleep better. Insomnia is often transient and intermittent. It usually requires treatment for only a short time, usually 7 to 10 days up to 2 weeks. If your insomnia does not improve after 7 to 10 days of treatment, see your doctor, because it may be a sign of an underlying condition. Some people have chronic sleep problems that may require more prolonged use of sleep medicine. However, you should not use these medicines for long periods without talking with your doctor about the risks and benefits of prolonged use.

Side Effects

All medicines have side effects. The most common side effects of sleep medicines are:

- Drowsiness
- Dizziness
- Lightheadedness
- Difficulty with coordination

Sleep medicines can make you sleepy during the day. How drowsy you feel depends upon how your body reacts to the medicine, which sleep medicine you are taking, and how large a dose your doctor has prescribed. Daytime drowsiness is best avoided by taking the lowest dose possible that will still help you sleep at night. Your doctor will work with you to find the dose of LUNESTA that is best for you. Some people taking LUNESTA have reported next-day sleepiness.

To manage these side effects while you are taking this medicine:

- When you first start taking LUNESTA or any other sleep medicine, until you know whether the medicine will still have some effect on you the next day, use extreme care while doing anything that requires complete alertness, such as driving a car, operating machinery, or piloting an aircraft.
- Do not drink alcohol when you are taking LUNESTA or any sleep medicine. Alcohol can increase the side effects of LUNESTA or any other sleep medicine.
- Do not take any other medicines without asking your doctor first. This includes medicines you can buy without a prescription. Some medicines can cause drowsiness and are best avoided while taking LUNESTA.
- Always take the exact dose of LUNESTA prescribed by your doctor. Never change your dose without talking to your doctor first.

Special Concerns

There are some special problems that may occur while taking sleep medicines.

Memory Problems

Sleep medicines may cause a special type of memory loss or "amnesia." When this occurs, a person may not remember what has happened for several hours after taking the medicine. This is usually not a problem since most people fall asleep after taking the medicine. Memory loss can be a problem, however, when sleep medicines are taken while traveling, such as during an airplane flight and the person wakes up before the effect of the medicine is gone. This has been called "traveler's amnesia." Memory problems have been reported rarely by patients taking LUNESTA in clinical studies. In most cases, memory problems can be avoided if

you take LUNESTA only when you are able to get a full night of sleep before you need to be active again. Be sure to talk to your doctor if you think you are having memory problems.

Tolerance

When sleep medicines are used every night for more than a few weeks, they may lose their effectiveness in helping you sleep. This is known as "tolerance." Development of tolerance to LUNESTA was not observed in a clinical study of 6 months' duration. Insomnia is often transient and intermittent, and prolonged use of sleep medicines is generally not necessary. Some people, though, have chronic sleep problems that may require more prolonged use of sleep medicine. If your sleep problems continue, consult your doctor, who will determine whether other measures are needed to overcome your sleep problems.

Dependence

Sleep medicines can cause dependence in some people, especially when these medicines are used regularly for longer than a few weeks or at high doses. Dependence is the need to continue taking a medicine because stopping it is unpleasant.

When people develop dependence, stopping the medicine suddenly may cause unpleasant symptoms (see *Withdrawal* below). They may find they have to keep taking the medicine either at the prescribed dose or at increasing doses just to avoid withdrawal symptoms.

All people taking sleep medicines have some risk of becoming dependent on the medicine. However, people who have been dependent on alcohol or other drugs in the past may have a higher chance of becoming addicted to sleep medicines. This possibility must be considered before using these medicines for more than a few weeks. If you have been addicted to alcohol or drugs in the past, it is important to tell your doctor before starting LUNESTA or any sleep medicine.

Withdrawal

Withdrawal symptoms may occur when sleep medicines are stopped suddenly after being used daily for a long time. In some cases, these symptoms can occur even if the medicine has been used for only a week or two. In mild cases, withdrawal symptoms may include unpleasant feelings. In more severe cases, abdominal and muscle cramps, vomiting, sweating, shakiness, and, rarely, seizures may occur. These more severe withdrawal symptoms are very uncommon. Although withdrawal symptoms have not been observed in the relatively limited controlled trials experience with LUNESTA, there is, nevertheless, the risk of such events in association with the use of any sleep medicine.

Another problem that may occur when sleep medicines are stopped is known as "rebound insomnia." This means that a person may have more trouble sleeping the first few nights after the medicine is stopped than before starting the medicine. If you should experience rebound insomnia, do not get discouraged. This problem usually goes away on its own after 1 or 2 nights.

If you have been taking LUNESTA or any other sleep medicine for more than 1 or 2 weeks, do not stop taking it on your own. Always follow your doctor's directions.

Changes In Behavior And Thinking

Some people using sleep medicines have experienced unusual changes in their thinking and/or behavior. These effects are not common. However, they have included:

- More outgoing or aggressive behavior than normal
- Confusion
- Strange behavior
- Agitation
- Hallucinations
- Worsening of depression
- Suicidal thoughts

How often these effects occur depends on several factors, such as a person's general health, the use of other medicines, and which sleep medicine is being used. Clinical experience with LUNESTA suggests that it is rarely associated with these behavior changes.

It is also important to realize it is rarely clear whether these behavior changes are caused by the medicine, are caused by an illness, or have occurred on their own. In fact, sleep problems that do not improve may be due to illnesses that were present before the medicine was used. If you or your family notice

any changes in your behavior, or if you have any unusual disturbing thoughts, call your doctor immediately.

Pregnancy And Breastfeeding

Sleep medicines may cause sedation or other potent effects in the unborn baby when used during the last few weeks of pregnancy. Be sure to tell your doctor if you are pregnant; if you are planning to become pregnant, or if you become pregnant while taking LUNESTA.

In addition, a very small amount of LUNESTA may be present in breast milk after use of the medication. The effects of very small amounts of LUNESTA on an infant are not known, therefore, as with all other prescription sleep medicines, recommended that you not take LUNESTA if you are breastfeeding a baby.

Safe Use Of Sleep Medicines

To ensure the safe and effective use of LUNESTA or any of sleep medicine, you should observe the following cautions:

1. LUNESTA is a prescription medicine and should be used ONLY as directed by your doctor. Follow your doctor's instructions about how to take, when to take, and how long to take LUNESTA.
2. Never use LUNESTA or any other sleep medicine longer than directed by your doctor.
3. If you notice any unusual and/or disturbing thoughts or behavior during treatment with LUNESTA or any other sleep medicine, contact your doctor.
4. Tell your doctor about any medicines you may be taking, including medicines you may buy without a prescription and herbal preparations. You should tell your doctor if you drink alcohol. DO NOT use alcohol while taking LUNESTA or any other sleep medicine.
5. Do not take LUNESTA unless you are able to get at least 7 hours of sleep before you must be active again.
6. Do not increase the prescribed dose of LUNESTA or any other sleep medicine unless instructed by your doctor.
7. When you first start taking LUNESTA or any other sleep medicine, until you know whether the medicine will still have some effect on you the next day, use extreme care while doing anything that requires complete alertness, such as driving a car, operating machinery, or piloting an aircraft.
8. Be aware that you may have more sleeping problems the first night or two after stopping any sleep medicine.
9. Be sure to tell your doctor if you are pregnant; if you are planning to become pregnant, or if you are breastfeeding a baby while taking LUNESTA.
10. As with all prescription medicines, never stop taking LUNESTA or any other sleep medicine without your doctor's advice. Always store LUNESTA or any other sleep medicine in the original container and out of reach of children.
11. Be sure to tell your doctor if you suffer from depression.
12. LUNESTA works very quickly. You should only take LUNESTA immediately before going to bed.
13. For LUNESTA to work best, you should not take it or immediately after a high-fat, heavy meal.
14. Some people, such as older adults (i.e., ages 65 and over) and people with liver disease, should start with the lower dose (1 mg) of LUNESTA. Your doctor should choose to start therapy at 2 mg. In general, adults under age 65 should be treated with 2 or 3 mg.
15. Each tablet is a single dose; do not crush or break the tablet.

Note: This summary provides important information about LUNESTA. If you would like more information, ask your doctor or pharmacist to let you read the Prescribing Information and then discuss it with him or her.

Rx only



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“The future of India lies in the hands of young Indians who are willing to stand up for themselves and... shun corruption.”

—Srinivas Balla
Arlington, Va.



HANDICAPPING INDIA'S CHANCES IN THE GLOBAL SWEEPSTAKES

OH, COME ON! It is time for Cricket World Cup, and the only thing on my mind and the minds of the other 1 billion-plus Indians is to see India win, or at least beat Pakistan. Nonetheless, “The trouble with India” (Cover Story, Mar. 19) points out some of the harsh realities of India among many other good things that India and Indians possess.

Being an Indian myself, I can say that if there is one word that best describes the Indian way of living it is “improvisation.” It is through this process that we circumvent all the pains caused by the corruption at the highest level of Indian bureaucracy. I was in India last year, and can attest that the future of India lies in the hands of young Indians who are willing to stand up for themselves and freedom, shun corruption and other maladies, and rise up to create and assimilate opportunities on the basis of their strong intellectual capital.

Making comparisons to China is a fair game. But here is my point: Despite the fancy roads, skyscrapers, and wealth, if a citizen does not have the

right to stand up for his views and rights without the intervention of the People's Republic of China, what kind of life is that?

—Srinivas Balla
Arlington, Va.

“THE TROUBLE WITH INDIA” featured a chart showing how India stacks up against the U.S. and China. One factor you could have compared is the number of years each has spent as a free country.

When India gained freedom from British rule 60 years ago, it used to import even the smallest things, like nails. Now it makes its own supercomputers and satellite launch vehicles. I am confident that India will soon overcome the issues of transportation, poverty, and hunger that it is facing. I would like to see a cover story comparing India's achievements vs. those of other major powers just 60 years after earning their freedom.

—Lakhbir Singh
Herndon, Va.

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BusinessWeek
 APRIL 9, 2007 (ISSN 0007-7135) *** 4029

Published weekly, except for one week in January, July and August by The McGraw-Hill Companies, Inc. **FOUNDER:** James H. McGraw (1860-1948).

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ReadersReport

mobility and individuals at every station of life have hope for a better tomorrow. China faces many of the same problems as India, but China, unlike India, can draw from and build on cultural traditions that include egalitarian ideals and merit-based opportunity. I'm confident that I'll see cars manufactured in Beijing tooling around San Francisco years before I see one from Delhi.

—Mark S. Miller
Richmond, Calif.

WHEN I RETURNED to India after a 10-year absence, it was truly a revelation. Cell phones, pagers, computers, and all manner of electronic gadgets seemed to be everywhere. Despite a sea of abject poverty surrounding islands of tremendous wealth, a newfound confidence and a sense of hope were palpable among young people everywhere.

However, until the system is transformed into one of a strict meritocracy, and until the culture within the government changes from one where obstructionist policies translate into larger bribes, India's infrastructure will continue to decay and the country will be relegated to playing second fiddle to China.

CORRECTIONS & CLARIFICATIONS

"Overlooked and underpriced" (Personal Finance, Mar. 26) incorrectly stated that Royal Bank of Scotland perpetual preferred stock paid cumulative dividends. Its dividends are noncumulative, meaning the company could skip dividends on the stock without paying them back. Although most perpetual preferred stocks have cumulative dividends, this one is an exception.

BusinessWeek misrepresented the comments of Wade Martin, president of the Dew Action Sports Tour, in "The making of a sports

mogul" (Sports Biz, Apr. 2). Martin did not criticize Wasserman Media Group's planned entry into a crowded market for broadband distribution of extreme sports events and should have been quoted as saying: "I don't think it is in the best interests of the industry to have multiple sites." Martin said he expects the sites to consolidate.

"A Blueprint from India" (Global Business, Apr. 2) incorrectly spelled the name of a Cadforce employee in Kolkata. Her name is Aditi Sengupta.

Then, after 60 years of independence, India could not blame the British for all her misfortunes, only herself.

—Arun K. Gadre
Louisville

AS A YOUNG, middle-class Indian, I am confident in my abilities, as well as those of my fellow young Indians, to change the current situation. India is in a position where the entire world may love us or hate us, but cannot ignore us.

I am not being ambitious when I say

that although we may not be on top of our game at present, we will be in the next five to six years.

—Manu Sharm
Manager, IBM India Ltd
Bangalore

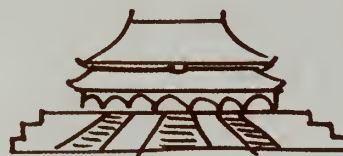
DON'T BASE CLIMATE CHANGE POLICY ON 'SKY IS FALLING' HYPE

THE CRITICISMS OF Jack and Su Welch's perspective on global warming ("The Welches need to face facts about global warming," Readers Report, Mar. 2007) are

UPS INTERNATIONAL SHIPPING



- ☐ AM
- ☐ Noon
- ☐ PM



- ☐ AM
- ☐ Noon
- ☐ PM

are, in my opinion, unjustified. Welch's "uscal's Wager" analogy, coming from a business guru, is clearly a green light for the American industry to "get moving." Similarly, we should, for our children's sake, "err on the side of caution." The Viches simply add: "There's no reason why I can't profit from it at the same time."

I hope the naysayers of the world can now join hands with others of like mind to discover innovative solutions to the challenge that lies ahead.

—James Eggert

Professor Emeritus

University of Wisconsin at Stout

Colfax, Wis.

IS IMPORTANT TO base public policy on reason and not on "sky is falling" hype. To the extent that sides are chosen and issues are politicized, where are the losers? What we know to date about the results of the InterGovernmental Panel on Climate Change is fragmentary and not the opinion of "hundreds of scientists." Rather, it is the work of a few individuals: scientists, bureaucrats, and politicians publishing the equivalent of an executive summary. Let's recognize the multidimensional nature of the issues in this sector and re-

sist the temptation to embrace simplistic solutions to complicated problems.

—Richard Fellenberg

Mashpee, Mass.

SUBPRIME LOANS: REAL ESTATE LAWYERS NEED TO SPEAK UP

FOR EVERY SUBPRIME loan in foreclosure, there was a lawyer at the table evidently not explaining the terms to the client ("Who will get shredded?" and "Under the fed's hammer," News & Insights, Mar. 19).

Mortgage brokers and banks make more money on subprime loans than with prime mortgages; transaction fees are higher, points are higher, application fees, processing fees, and underwriting fees are all higher. Everyone in the deal makes extra money on the transaction but the lawyer. There is more money to go around, paid for by the poorest among us—those who are excited about buying a house but with no experience and knowledge of what the fees should look like.

For every interview I read with a borrower whose loan has been reset and is having a hard time making the payments or is in foreclosure, I say, where was your lawyer? As an independent adviser with no

skin in the deal except a modest fee, I ask, what was his advice? Did he explain the loan's terms and the risks? Did he review the pre-approval, the good faith estimate, and the commitment? Did he explain all of the closing costs, fees, and charges, and advise his client about the mortgage market, not just rates but terms and costs? If so, then, let the buyer (and bank) beware.

—Martin Novar

New York

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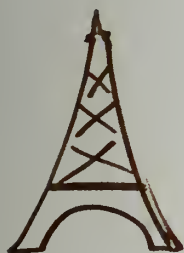
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Now Playing: Digital Disarray

Imagine a bookstore that sells only works published by Random House. If you want a HarperCollins title, you have to go to the store down the street. In this world, you're permitted to read Penguin books either on the train or lying in bed, but Vintage books can only be read on the couch. It's absurd—but no more so than the world of video downloads as they exist today.

The problem is that the quickly growing stock of movies and shows available for download is scattered among an assortment of stores including Movielink, CinemaNow, Google Video, and Amazon.com Unbox, as well as Apple's iTunes Store. And while there's a lot of overlap, there's also a significant amount of content exclusive to one or another service.

This has happened because the digital-download business isn't like any other sort of retailing. Any bookstore can order any book in print from its publisher. And once customers buy it, they can do whatever they wish with it. But download services must negotiate their rights studio by studio, sometimes title by title. And the deals cover not only which movies and TV shows are available but also what sort of video quality can be offered at what price, and, in excruciating detail, just what consumers can do with the video they have bought or rented.

CONSIDER THE RULES covering movies purchased from Movielink, typically for \$13.99 (different rules cover rentals). You can watch your movie as often as you want, but only on a Windows PC. Some films can be watched on up to three different PCs; others can't. You can make a backup copy to DVD, but you must copy it back to a pc to view it; you can't watch it on a standard DVD player. And there's no way to watch on a handheld device. Rival CinemaNow has a service that lets you burn a movie to a standard DVD—but it only offers 112 titles. Unbox lets you watch movies on up to two Windows PCs or some TiVo video recorders (selected titles only), and you can copy the film to a handheld, but only if it runs Microsoft Windows Mobile Media Center software.

This is insanity. It's no wonder none of these download services has developed any real traction in the market. (The tech-savvy will point out there are ways to obtain content online without the fuss of restrictions, or paying. Yes, but these downloads are illegal, as is extracting video from copy-protected DVDs that you own.)



Hollywood's piracy fears are stifling online video expansion

content on your PC unless you view it in a copy-guarded way approved by the studios. So far, no Blu-ray or HD-DVD disk has encoded this feature, but it is available.

The common thread linking these issues is a Hollywood fear of piracy so overwhelming that the studios are forgoing big revenue opportunities. Sooner or later they will come to their senses and deliver all of their content online in ways that are actually convenient for consumers. Until that happens, the downloaded entertainment revolution is going to remain on pause. ■

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NewTube Is Just the Beginning

Give it up for NBC Universal and News Corp., because in late March the two old-media titans made the biggest splash for a nonexistent product since the iPhone. **5** Of course, Steve Jobs has a couple of prototype phones that a lucky few can dandle. News Corp. and NBC Universal have nothing to show for their ambitious Web video destination site and service (not

even a name, so I'll call it NewTube), aside from syndication agreements with Yahoo!, Microsoft's MSN.com, and Time Warner's America Online, along with a fairly detailed business brief. Among other things, NewTube's videos can be embedded on any site, YouTube-style. But unlike YouTube thus far, they'll come with Big Media-approved copyright protection and, at least in some cases, a small share of ad revenues.

For media geeks, NewTube (its executives, unsurprisingly, prefer the clunkier handles NewCo or NewSite) is big news. But the venture, expected to launch this summer, is merely one of myriad developments that will remake the world of Web video in the next few months. Google is expected to begin rolling out advertising systems for YouTube this summer. This spring, News Corp.'s MySpace will formally push into YouTube's video-sharing turf, launching an offering that insiders currently call MySpace TV. And top executives at Time Warner suddenly sound confident that a mutual technical solution to copyright issues with YouTube—the subject of a lawsuit Viacom filed in mid-March—is close enough to make likely a content-licensing deal. (Spokespersons for YouTube and other companies declined to discuss potential deals or negotiations.) Mingling within these overlapping layers of competition and cooperation is the suddenly less remote prospect of making some actual money.

A COMPLEX CROSS-COMPANY PLAY like NewTube comes with a dense thicket of issues to hack through. Networks don't own many of their TV shows, for instance, which will make divvying up those revenues an interesting negotiating experience. Another is that NewTube's sales force will primarily start out selling pre-roll ads, which run before



video clips. This is a format the freer-form video-sharing sites have wisely shunned because it makes for a lousy experience.

While NewTube will feature short clips from established shows at launch it probably won't allow users to chop up and share favorite bits of, for instance, *The Office*—

CHOP IT UP?

Users won't share bits from *The Simpsons* or *The Office*

which is exactly what helped YouTube explode. (Although it will allow users to create mash-ups.) On a conference call he in the wake of the announcement, NBC Universal CEO Jeff Zucker and News Corp. President Peter Chernin said NewTube

will leave consumer-produced video to the YouTubes of the world—so semipro video effluvia, like grainy live band footage, will be more or less absent from NewTube. (Possible exception: NewTube users' parodies of programming already featured on the site.) And there are the enormous tasks of making the technology work and keeping all the egos in check. But that NewTube's videos will be distributed widely throughout the Web, rather than being locked up on one central site, indicates that the current climate has already shrunk some heads and forced TV executives to embrace less controlled means of distribution.

At press time, Google and YouTube hadn't signed on as distribution partners with NewTube, although some seem confident they will. There is a carrot here: shares in ad revenue from big advertisers, since the likes of General Motors and Intel have already signed on. YouTube might want to feature NewTube clips, since they would net it additional monies. In a perfect world, NewTube offers YouTube a carrot to play along with copyright holders on the sorts of issues that outraged the Viacom of the world. Perhaps a YouTube competitor could end up bringing the *ur*-video-sharing site into the light. Could, that is. This is media in the 21st century. Any predictions must be framed with a fistful of "ifs." ■

BusinessWeek .com



For Jon Fine's blog on media and advertising, go to www.businessweek.com/innovate/FineOnMedia

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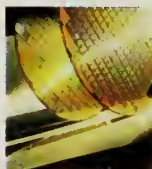
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The Proven Path to SuccessSM

BY JAMES C. COOPER

The Real Economic Threat: Weak Capital Spending

Corporate caution could jeopardize job growth and consumer outlays

U.S. ECONOMY

What's the biggest threat to the economy? The housing slump, right? After all, therein lies the greatest potential to derail consumer spending. Well, think again. Amid all the headlines about builders' woes, sagging home prices, and shaky subprime mortgages, there's some trouble brewing in another sector, perhaps

more crucial to the outlook: capital spending.

Business outlays for new equipment and facilities have slowed sharply over the past year. That's important because when businesses expand their operations they also add to their payrolls. Job growth over the past couple of years has been the primary support under consumer spending, so any sharp slowdown in capital spending would most likely have an even broader impact on consumers than the weakness in housing.

Inflation-adjusted expenditures for things like computers, heavy machinery, factories, and warehouses grew only 3.9% per quarter during the final three quarters of 2006, after increases averaging 8.2% in the previous three quarters. Spending in the final quarter of 2006 dropped for the first time in almost four years, and there's more weakness to come. In January and February, orders for capital equipment have fallen sharply, putting them far below their fourth-quarter level and suggesting the economy will struggle to reach a 2% growth rate in the first quarter.

The odd feature of this weaker spending pattern is that it has occurred during a period when the fundamental drivers of business investment have been generally strong. Based on robust earnings and record profit margins, the prospective returns on new plants and equipment have been high, even as investment costs have been low. The cost of borrowing in the credit markets remains relatively cheap, and banks, on balance, have not tightened their lending standards for their corporate customers. Companies also sport exceptionally high levels of corporate cash and solid balance sheets.

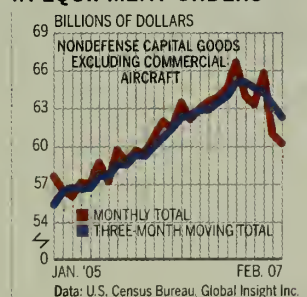
HIS DISCONNECT between the ability and desire of companies to spend appears to reflect a sharp turn toward caution in the boardroom. Companies have been rocked by one uncertainty after another since 2000, including recession, corporate scandals, terrorist attacks, war, and a tripling of oil prices. The latest round of worries began last year amid growing fear that the housing recession would spread to the rest of the economy. Those concerns have been reinforced by the subprime loan debacle and another bounce in the price of oil back to more than \$60 per barrel.

Even before the big stock market swoon on Feb. 27, which was related to the subprime mess, the general outlook of chief executives surveyed by the Business Roundtable was relatively subdued compared with their attitudes in 2005 and early 2006. Chief financial officers queried by Duke University offered a similar take.

After Feb. 27, attitudes are bound to have soured. The UBS Index of Investor Optimism for March dropped to its lowest level in six months, reflecting diminished expectations for stock prices and a less upbeat inflation outlook. Those attitudes were driven by real estate woes and a nearly 20% resurgence in gasoline prices since late January. Those were undoubtedly factors in the March drop in consumer confidence as well.

As for corporate confidence, one of the best indicators is businesses' willingness to plunk down money for new equipment, a trend that has gone south in recent months. Orders for capital goods, such as machinery and high-tech hardware (outside of defense items and commercial aircraft), fell 1.2% in February, the fourth decline in the past five months. The three-month moving average of orders, which

A SUDDEN DOWNTREND IN EQUIPMENT ORDERS



gives a good reading of the trend, has dropped sharply after heading almost straight up for about two years (chart). The longer companies keep their capital-spending plans on hold, the more vulnerable the economy will be to other downdrafts, such as any new surprises from the housing market.

THE CURRENT SLOWDOWN in capital spending is actually part of a longer-term hesitancy on the part of businesses to expand their plants and equipment. Throughout this five-year expansion, the growth in outlays has failed to match the pace of the 1990s

expansion, even prior to the boom late in the decade.

For the past four years, the real, or inflation-adjusted, stock of equipment and software in place at nonfinancial corporations has generally not grown any faster than that sector's real gross domestic product, based on Federal Reserve data (chart). That suggests the 4.4% growth rate in equipment outlays in 2006, the slowest in three years, has been insufficient to keep up with the rate at which old computers and machines are wearing out.

Companies aren't wary only about spending. They also seem unwilling to borrow for anything other than financing stock buybacks and taking their businesses private. Recent Fed data show that nonfinancial corporations last year, on net, retired a record \$602.1 billion in equity. In the fourth quarter alone, they set aside \$701.2 billion, measured at an annual rate, far more than the additional \$604.6 billion they borrowed in the credit markets. Companies seem interested in cutting their overall cost of capital, but they don't seem very hot on taking advantage of cheaper capital to invest in expanding their operations.

THE ANSWER TO THIS PARADOX goes back to corporate prudence, and the heavy demands investors have placed on companies to perform. Capital-spending decisions depend most crucially on prospects for demand, which has slowed in recent quarters, with little to suggest a pickup. Recent news that sales of new single-family homes plunged to the lowest level in more than six years, along with new evidence of falling house prices, only reinforces the perception that demand is softening.

Businesses may be worried that the profit machine of the past few years is about to slow down, and they could be right. With labor markets tightening and productivity slowing, unit costs are picking up speed relative to prices. That means the profit margin on many goods and services is getting squeezed, a factor that

could hammer earnings as revenues slow.

That might already be happening. The ratio of negative to positive earnings pre-announcements for the companies in the Standard & Poor's 500-stock index for the first quarter of 2007 is running at 3.3, according to Thomson Financial.



announcement by a company saying it will beat its earnings expectation, more than three companies expect to miss their projections. That reading is higher than at this point in the fourth-quarter earnings season, and it is also well above the historical average of 2.0.

So don't get too fixated on every dire headline about the housing recession. The key to the staying power of this economic expansion will be the spending decisions of U.S. businesses, and in coming months they will need plenty of convincing that the economy is on solid ground before they commit to parting with their money. ■

CONSUMER DEBT

Borrowing Like There's No Tomorrow

CONSUMERS ARE piling up credit-card debt at the fastest pace in years, and the housing downturn may be the reason. If households continue to rely on credit cards, it could leave them more financially vulnerable to any further economic slowdown.

In January, revolving credit, made up largely of credit-card debt, was up \$52.7 billion, or 6.4% from a year ago. Consumers haven't racked up revolving debt at such a clip since late 2001. And the pace looks set to quicken in February. A large chunk of the \$6.8 billion increase expected by economists likely will be in the form of new credit-card debt, as

nonrevolving credit probably cooled off with slower auto sales.

The timing of the acceleration in revolving credit suggests consumers are turning to their credit cards as a partial replacement for reduced mortgage equity withdrawal, says Goldman Sachs senior economist Ed McKelvey. According to his calculations, increases in revolving

credit have offset about 20% of the decline in cash-out refinancing or increased home-equity lines of credit since late 2005.

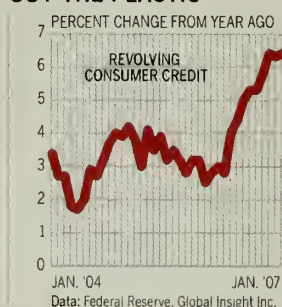
Consumers who no longer can, or wish to, tap their home's equity, but instead fund spending with credit cards, are making an expensive

decision. The average interest rate on a credit card is more than 13%, far above the average rate for a home-equity line of credit. In addition, most interest expense on home-equity loan is tax-deductible. By relying more on credit cards, consumers run the risk of raising their overall debt burden, which, at 14.5% of aftertax income, is already the highest level on record.

With labor markets and income growth still appearing strong, it looks like consumers can shoulder the extra debt burden, for now. "If wage income grows enough to offset increased debt, then consumers will be fine," says McKelvey. But the strength of the job market and the economy hinges largely on whether housing woes spread. If conditions deteriorate, many consumers could get squeezed hard by their decision to keep on borrowing. ■

—By James Mehring in New York

CONSUMERS PULL OUT THE PLASTIC





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The BusinessWeek

NEWS YOU NEED TO KNOW EDITED BY HARRY MAURER



HOUSING: IT ISN'T PRETTY

Don't hold your breath for housing to get back on a solid foundation. New-home sales tumbled 4% in February—Wall Street economists were banking on 6.7% growth—and government statisticians sharply cut previously reported sales estimates for November through January. That cooling demand is crunching homebuilders: Florida-based **Lennar** (photo, a Miami development) on Mar. 27 said earnings fell 73% in the quarter ended Feb. 28, following similarly dour profit reports from **KB Home**, **Hovnanian Enterprises**, and **Toll Brothers**.

Mortgage lenders continue to get hammered, too. *The New York Times* said on Mar. 28 that subprime giant **New Century Financial** could file for bankruptcy shortly. And BusinessWeek.com reported on Mar. 27 that federal investigators have launched a criminal probe into lending practices at **Beazer**, the sixth-largest residential builder. See "A builder's lending under scrutiny," page 32, [ONLINE](#) "Lennar report adds to homebuilders' gloom," www.businessweek.com/go/tbw

Citi May Slim Down

Will laying off thousands help keep **Citigroup CEO Charles Prince** at the helm? *The Wall Street Journal* said on Mar. 26 that the bank may eliminate up to 15,000 positions, about 5% of the workforce, as part of a \$1 billion restructuring scheme aimed at cutting costs and mollifying shareholders. The plan could become official when Citi reports earnings on Apr. 16. Initial investor reaction

was lukewarm, with some analysts saying Prince may have to chop even more.

ITT Pays a Fat Fine

Watch those exports: As *BusinessWeek* first reported on Feb. 1, heightened vigilance by the feds landed ITT in duteh for sending classified night-vision technology to prohibited nations, notably China. Now, ITT will pay. The company on

Mar. 28 pleaded guilty to two felonies and agreed to a \$100 million penalty, the largest ever for flouting arms export controls.

[ONLINE](#) "ITT to plead guilty in export case," www.businessweek.com/go/tbw

They're in the Chips

For rivals **Intel** and **IBM**, the chip race never stops. On Mar. 26, Intel said it will lavish

\$2.5 billion on a wafer fab in China. Making chips locally will cut the need for costly shipping, and the technology infusion will please Beijing, improving relations in one of Intel's biggest markets. Two days later, Intel countered **AMD's** recent buy of graphic chipmaker **ATI**, announcing it will build graphics directly onto its processors soon. **Big Blue**, meanwhile, said it has created an optical chipset that will be able to download a high-definition movie in seconds. That chip could hit the market by 2010.

[ONLINE](#) "Intel and AMD take chip fight to China," www.businessweek.com/go/tbw

Software Square-Off

Oracle filed a Mar. 22 lawsuit against **SAP** that says employees associated with German company stole some 10,000 computer files from Oracle's technical support system—then used them to improve its own products. In an unrelated event, **SAP** product development chief **Shai Agassi** said on Mar. 28 that he's quitting. He had been considered a candidate to succeed **CEO Henning Kagermann**.

See "Oracle vs. SAP: Sound or fury?" page 38

A Telco's Big Score

Alcatel-Lucent on Mar. 26 said it had captured a \$6 billion three-year contract with **Verizon Wireless**—a much-needed vote for the equipment giant, the product of last year's \$17 billion merger of **France Telecom** and New Jersey's **Lucent Technologies**. The deal, the biggest in Alcatel's history, follows a January warning that prompted market to question the combo's move. [ONLINE](#) "Alcatel-Lucent bag Verizon deal," www.businessweek.com/go/tbw

Look Out, YouTube

BC Universal and News Corp.

announced on Mar. 22 that they'll join in creating their version of online video site YouTube—and that they'll treat copyright as holy writ. See "NewTube is just the beginning," page 22

Teaming in Shanghai

So much for the great China stock blowout. Since the 10% sell-off on Feb. 27 that took down global markets, mainland prices have resumed their incredible levitation act. On Mar. 28 the Shanghai & Shenzhen 300 Index finished up 7%, at a record 2797.65. It shot up 7.4% over the previous eight trading sessions, 37% for the year, and nearly 170% over 52 weeks.

LINE "China rides the per-growth tiger," www.businessweek.com/go/tbw

Stents: Going Nowhere?

Boston Scientific's market-leading arterial stent business suffered yet another blockage. A study released on Mar. 26 showed that 2,287 patients with coronary disease found that stents were no better than drugs at reducing off heart attacks over a 4½-year period. The company pointed out that the primary benefit of its stents

is to reduce chest pain, but alarmed investors whacked the stock by 7% that day.

Front-Runner Zell

As Tribune Co.'s halting sale process approached its Mar. 31 deadline, press accounts conferred lead-dog status on real estate investor Sam Zell. The reports put Zell's bid at around \$8 billion. The news came as newspaper companies owning properties in large markets, including Tribune, reported nasty ad revenue drops in February.

Transatlantic Freedom?

Open Skies may finally be on the horizon. On Mar. 22, European Union transport ministers approved a deal to lift restrictions on flights across the Atlantic, ending three decades of dogfights. Europeans won a key concession that calls for the deal to be scrapped unless Washington begins talks within two years to open its domestic routes and allow more foreign investment in U.S. carriers. The Bush Administration is expected to sign off on the deal on Apr. 30, and it's slated to take effect in March, 2008.

ONLINE "A flight plan through Open Skies," www.businessweek.com/go/tbw

INDICTMENT OF THE WEEK

Former White House Budget Director David Stockman earned notoriety in the 1980s for publicly criticizing the Reagan Administration's budget even as he lobbied Congress to pass it. Now he finds himself in considerably hotter water. On Mar. 26 the Justice Dept. accused Stockman of duping lenders and investors in a complicated plot to conceal financial woes at Collins & Aikman. Stockman resigned as president and CEO in 2005, just before the Michigan auto-parts maker filed for bankruptcy. The onetime boy wonder—he was just 25 at the time of the budget snafu—has pleaded not guilty to felony counts of conspiracy, securities fraud, bank fraud, and wire fraud. He says he lost a fortune trying to save the company, moving into a motel near corporate headquarters in the final days, working without pay, and absorbing millions of dollars in expenses. Prosecutors also charged former CFO Michael Stepp, former Controller David Cosgrove, and former purchasing Director Paul Barnaba, all of whom also declared their innocence.



DAVID STOCKMAN

With the AT&T-Cingular merger, one thing remains unchanged.

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LABOR

WHERE ARE ALL THE WORKERS?

Companies worldwide are suddenly scrambling to manage a labor crunch

BY PETER COY AND JACK EWING

EMPLOYERS IN SOME UNLIKELY places say they're having trouble filling jobs. Factory managers in Ho Chi Minh City report many of their \$62-a-month workers went home for the Tet holiday in February and never came back. In Bulgaria, computer experts are in such demand they can't be bothered to answer the want ads of a Los Angeles movie studio. And in Peoria, Caterpillar Inc. is struggling to train enough service technicians. The problem in each case: not enough people who are both able and willing to do the work for the posted pay. "We've got a global problem...and it's only going to continue to get worse," says Stephen Hitch, a human resources manager at Caterpillar.

A global labor crunch, already being felt by some employers, appears to have intensified in recent months. That's in spite of widely publicized layoffs, including Citigroup's plans to shed as many as 15,000 staffers. In fact, U.S. unemployment remains low—just 4.5% in February—and even companies in countries with higher jobless rates are feeling pinched. "It's not just a U.S. phe-

nomenon," says Jeffrey A. Joerres, CEO of Manpower Inc., the staffing agency. On Mar. 29, Manpower was to release the results of a survey of nearly 37,000 employers in 27 countries. The study found that 41% of them are having trouble hiring the people they need.

What's going on here? With global growth running at a strong 5% a year since 2004, the strategies that companies developed to hold down labor costs—including offshoring work to low-wage countries—are running out of gas far sooner than many expected. The seemingly inexhaustible pools of cheap labor from China, India, and elsewhere are drying up as demand outstrips the supply of people with the needed skills. "Companies were hoping they wouldn't have to worry about human resources at all," says Peter Cappelli, director of the Center for Human Resources at the University of Pennsylvania's Wharton School. "Now they do."

Corporations are determined to keep labor costs under control, so they're reaching deeper into their bag of tricks. Some are doing more in-house training so they don't have to recruit pricey talent

ILLUSTRATION BY SEAN MCCABE; PHOTOGRAPHS BY (CLOCKWISE FROM TOP LEFT): CORBIS/JUPITER IMAGES; CHRIS BUDGEON/NONSTOCK/JUPITER IMAGES; CORBIS/JUPITER IMAGES; INGRAM PUBLISHING/JUPITER IMAGES; PIERRE BESSARDREA/REDUX; CREATAS IMAGES/JUPITER IMAGES; CORBIS/JUPITER IMAGES







CAT SCHOOL The equipment maker is rushing to train service techs

ering around a 5 year high. With many people new available for work in China, India, and the former Soviet Union, the only thing that could cause a real shortage would "a global pandemic that kills millions of people," Harvard University economist Richard B. Freeman wrote in a research paper in September.

But try telling that to employers who workforce strategies, developed for a period of surplus labor, don't fit the new realities. The challenge is finding people who can do the jobs on offer. Manufacturers in Japan are suffering a lack of skill workers because of the country's aging population as well as downsizing during the 1990s. "Now they're paying the price for not developing human resources," says Hisashi Yamada, an economist at the Japanese Research Institute in Tokyo.

China, although far more youthful than Japan, could soon feel the same pinch. Sure, its biggest problem at the moment continues to be creating jobs for the millions of workers pouring into cities, as wages are barely rising overall. But that may be starting to change as the government boosts incentives for people to stay in rural areas and most factories remain concentrated in a few coastal regions. In an article published in early March in the *China Daily*, Beijing economist Chen Fang said China is approaching a "Lewisian Turning Point." That's a reference to the late Nobel laureate Sir Arthur Lewis, who said a developing nation's industrial wages begin to rise quickly at the point when the supply of surplus labor from the countryside tapers off.

Cost-conscious employers around the world are fighting to hold the line on labor. In Japan, the core rate of inflation in

on the open market. Some are lowering their standards for new hires or moving operations to virgin territories other outsourcers haven't discovered, such as the Belarusian capital, Minsk, or smaller cities in Bulgaria and Romania.

WRITE YOUR OWN TICKET

FOR NOW, THOUGH, workers with skills that are in short supply are enjoying the ride. If you're a petroleum engineer in Colorado, where energy companies such as Shell, EnCana, and Halliburton are hiring like mad, you can write your own ticket. Even unskilled workers are being snapped up, says Sue Tuffin, director of the Mesa County Workforce Center in Grand Junction, Colo. "Parents are trying to convince kids to stay in school," she says, but the lure of the gas fields is strong: "You can go to work on a drill rig with no training and make \$30 an hour." Pittsburgh-based Consol Energy Inc. is so desperate for coal miners that it's staging a media campaign that includes billboards, the Internet, and its first-ever television commercials. In agriculture, the crackdown on illegal immigration has dried up farm labor so much that crops were left rotting in the fields last year. Even Michigan, which has the nation's highest unemployment rate, is reaching out to migrant farmworkers from Texas and, soon, Florida. Its slogan is "Venga a Michigan"—Spanish for "Come to Michigan."

The job U.S. employers say is hardest to fill is sales representative. The trouble

is, companies can't find people with the technical expertise and business savvy to explain complex products to customers, Manpower says. Right behind them on U.S. employers' wish lists are teachers, mechanics, and technicians. "There are certain professions where skills are in such demand that even average or below-average people can get hired," says Michael Alter, president of SurePayroll Inc., which keeps tabs on the labor market as it processes small-business payrolls.

Economists, of course, will tell you there's no such thing as a labor shortage. From a worker's viewpoint, many so-called shortages could quickly be solved if employers were to offer more money. And worldwide, millions of people still can't find jobs. The strongest evidence that there's no general shortage today is that overall worker pay has barely outpaced inflation. In the U.S., the share of national income going to corporate profit, rather than, say, labor, is hovering

Help Wanted

Where the labor shortage is hitting hardest

COUNTRY/ REGION	COS. HAVING TROUBLE FILLING JOBS*	SKILLS MOST IN DEMAND
MEXICO	82%	Factory workers, laborers, accountants
JAPAN	61%	Sales representatives, secretaries
U.S.	41%	Sales representatives, teachers
CANADA	36%	Plumbers, electricians, welders, sales reps
EUROPE	31%	Plumbers, electricians, engineers
CHINA	19%	Lab workers, laborers, factory hands
INDIA	9%	Engineers, IT staff

*From a survey of 36,629 companies in 27 countries. Data: Manpower Inc.

January was precisely zero, in part because corporations are keeping wage increases to a minimum. Instead, Japanese businesses are going with other gambits, such as hiring temps full-time, increasing mechanization, offshoring work, and retiring retirees. Toyota Motor Corp., for instance, is asking some workers over to delay their retirement a year or more. In Europe, Swiss staffing company Adecco is teaching Polish carpenters to speak Norwegian so they can fill construction jobs in Oslo.

CENTRAL EUROPE

Desperately Seeking Bulgarian Programmers

BY JACK EWING

Wanted: programmers. Chance to inhale a whiff of Hollywood, dream up special effects for films, and make decent money to boot. Sounds like a pretty good gig, especially in Sofia, the bleak capital of Bulgaria, the poorest country in the European Union. But Los Angeles-based Nu Image, which operates a low-cost production center in Sofia, isn't exactly facing a stampede of computer grads to help it digitally enhance films such as the latest *Rambo* sequel. In fact, Scott Coulter, visual effects producer for Nu Image, says his help-wanted ads sometimes get zero response. "I'm having a hell of a time," he says.

If you're a Bulgarian programmer, a Romanian network-systems engineer, or a Czech enterprise-software specialist, life is good. Salaries for information technology workers in Central Europe are rising by double digits annually as multinationals such as Hewlett-Packard, SAP, and Dell dive into the region, soaking up what was supposed to be a deep pool of math and science graduates willing to work for a third of what their Western European counterparts are paid.

As it turns out, the supply of qualified labor is proving surprisingly finite. And it's not just IT specialists, but also managers, accountants, engineers, and more. Call-center managers

or IT directors in Poland can cost companies more than \$100,000 a year including benefits, while even call center operators cost up to \$23,000, staffing company Adecco says. So big companies are paying more and migrating to the hinterlands to find good, low-cost labor. Finnish mobile-phone maker Nokia, which already employs nearly 5,000 people in Hungary, announced on Mar. 26 it will build a new handset factory in Romania. And New Jersey-based EPAM Systems, which develops software for the likes of Microsoft and SAP, is scouting locations in Russia.

The problem is most acute for smaller companies that don't have the cachet and resources of the big multinationals. Many have already been priced out of the capitals. Hilscher, a fast-growing German maker of communications gear, chose to locate a new development center in Varna, a city on Bulgaria's Black Sea coast that is home to a technical school. "There's too much

competition in Sofia," says Oleksandr Shcherbina, Hilscher's quality chief.

Local IT executives already know they need to compete on more than just price. "If you build your economic model only around low-cost labor, you have a three- or four-year window where you have an advantage," says Sasha Bezuhanova, head of Hewlett-Packard's



SHORT IN SOFIA
Coulter's want ads get little response

operations in Bulgaria. HP, which plans to expand to more than 1,000 employees in Sofia by yearend, from

600 today, is subsidizing computer courses at local universities to ensure a steady flow of workers.

Employers in Central Europe not only compete with each other but with Western Europe. Romania's shortage of skilled labor has been aggravated by the estimated 2.5 million citizens—out of a population of 22.3 million—who have decamped for work abroad. But the globalizing labor market can help, too. Bulgarian Andrey Kalo spent nearly a dozen years at various jobs in San Francisco before HP lured him back to his native Sofia to help manage servers for big customers. The pay is a bit less, but the low cost of living means he can afford a better lifestyle. Says Kalo: "I'm quite happy to be back."

—With Antonia Oprita in Bucharest

THE STAT

2.5
MILLION

Romanians who have emigrated for work

Data: Interior & Public Administration Ministry (Romania)

Caterpillar, meanwhile, is redoubling in. A network of vocational schools in six countries teaches a Caterpillar-approved curriculum, and students enter it with a dealership already committed to hiring them. They will spend up to half their time in apprenticeships at Cat dealerships, learning on the job.

The labor squeeze in India gets lots of attention. Oddly, though, Manpower's survey found that employers in India reported the least problems filling jobs:

Just 9% said they had difficulty, vs. 41% in the U.S. and 82% in Mexico. The explanation? Manpower's staff thinks turnover is so rapid in India that employers figure if they really need to fill a job, they'll lure someone away from another company. But stealing scarce talent from rivals isn't a strategy for the long run. That's why employers are on an all-out campaign to increase training and raise education levels. While India produces 400,000 engineering graduates a year,

few have the skills and language abilities to work in an advanced multinational corporation. Some 1.3 million people applied to tech-services giant Infosys Technologies Ltd. last year, for instance, but the company says only 2% of those were employable. For business, it seems, there's no shortage of work involved in easing worker shortages. ■

—With Ian Rowley in Tokyo, Michael Arndt in Chicago, Dexter Roberts in Beijing, and Nandini Lakshman in Mumbai



MORTGAGE MESS

A BUILDER'S LENDING UNDER SCRUTINY

Federal investigators are looking into Beazer's mortgage practices

BY DAWN KOPECKI

AMID THE SUBPRIME meltdown, mortgage brokers and lenders that cater to risky borrowers have come under fire. Now one major homebuilder is feeling the heat. Federal investigators, as first reported by BusinessWeek.com, have opened a criminal probe into the lending practices of Beazer Homes USA Inc.

Atlanta-based Beazer, which operates in more than 40 markets across the country, rode high during the housing boom, profiting from selling the homes it constructed as well as financing some of the buyers who moved into them. It's a common industry practice, but the feds are worried Beazer may have pushed the bounds. Last week the FBI, the Internal Revenue Service, the Justice Dept., and the Inspector General of the Housing & Urban Development Dept. started looking into the com-

pany's mortgage business and other dealings. "We're looking at all types of [potential] fraud associated with Beazer—corporate, mortgage, investments," says FBI spokesman Ken Lucas, noting the joint investigation itself doesn't prove any wrongdoing. Beazer said in a press release on Mar. 28 that it was fully cooperating with a document request by the U.S. Attorney: "Beazer Homes has a long established commitment to managing and conducting business in an honest, ethical, and lawful manner."

The Beazer inquiry is just the latest twist in the subprime saga, marking the first known federal investigation into the mortgage lending arm of a national homebuilder. As default and foreclosure rates have sky-

CONSTRUCTION

A Beazer subdivision going up in Goodyear, Ariz., near Phoenix

rocketed, stories of predatory lending practices have surfaced. As with others caught in regulators' sight

the worry over Beazer may be whether its lending arm aggressively pushed loans to home buyers who ultimately couldn't afford them and perhaps doctored loan applications to qualify those borrowers. Beazer financed a large number of mortgages for low-income borrowers, loans often insured by the federal government through Ginnie Mae. *The Charlotte Observer* reported in mid-March on unusually high foreclosure rates at a handful of Beazer housing developments in North Carolina and abusive lending practices, allegations the company disputed in its recent statement.

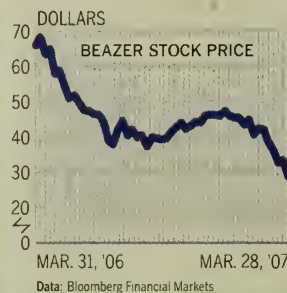
Still, this new wrinkle raises the question of whether Beazer's troubles are isolated. Increasingly homebuilders have relied on in-house mortgage arms as part of their sales technique. There's nothing inherently wrong with that approach. But with the entire housing industry under a microscope, some regulators are taking a closer look at such relationships. Mark Pearce, North Carolina's deputy banking commissioner, sent a letter in early March to all lenders and brokers in the state, including Beazer, saying his office was scrutinizing the industry's dealings with builders as part of a broader examination of mortgage practices. "Builders and lenders may have aligned interests in selling a house and making a mortgage loan. It may be not the best interest of the borrowers," says Pearce. "There is an incentive structure there to close the deal."

For Beazer, the investigation marks the darkest mark on an already tough year. Earnings per share dropped 9

in 2006. On Feb. 1, Beazer fired its chief counsel "for a pattern of personal conduct, which included violations of company policies." Meanwhile, the stock has dropped from around 70 to a low 29 over the past year—falling more than 8% in the days after the news of the inquiry broke. ■



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ADVERTISING

COLD CASH FROM A HOT SITE

Can MySpace pull in revenue fast enough for Rupert?

BY RONALD GROVER

AS NUMBERS GO, THIS one's a whopper. Last year MySpace users called up an average of 31.5 billion unique page views per month. That's as though everyone on the planet visited the site once a week. And yet, the big kahuna of social networking racked up a paltry \$90 million in ad sales. Not exactly what Rupert Murdoch had in mind when his News Corp. paid \$580 million for MySpace nearly two years ago.

Now Murdoch's bet may be about to pay off. This year, if everything goes according to plan, MySpace could generate ad revenues of some \$271 million, figures Merrill Lynch & Co. analyst Jessica Reif Cohen. She also predicts that in 2008 Fox Interactive Media (FIM), of which MySpace is the largest piece, will generate its first profit, an estimated \$208 million (although an ad sharing deal with Google will account for some of that).

That's not to say getting there will be easy. Though page views were up 79% last month over the previous year, growth is slowing. Plus MySpace is aging: 41% of the traffic comes from people over 35 vs. 35% a year ago, says researcher Hitwise; not ideal for youth-obsessed advertisers. Then there is the small matter of putting ads on a site whose denizens are averse to anything that clunks up



the experience. "Rupert was very straightforward," says co-founder Chris DeWolfe. "Don't compromise anything, but find a way to make money."

That's why MySpace is looking for content that will appeal to its finicky customers. DeWolfe and co-founder Tom Anderson pushed hard to be part of the initiative from News Corp.'s Fox unit and NBC that will put prime-time TV shows on the Web as early as this summer. Says News Corp. President Peter Chernin: "It's free content

THEIR SPACE
Founders DeWolfe and Anderson

THE STAT

\$1.16
billion

MySpace's projected revenues in 2010, up from \$92 million last year

Data: Merrill Lynch & Co.

and a guaranteed piece of advertising sales." To augment that, MySpace aims to double the already large number of consumer-made videos on the site by adding professionally made fare that commands higher ad rates. The first venture: a series of 90-second shorts called *Prom Queen* from former Walt Disney Co. CEO Michael D. Eisner that will begin appearing Apr. 1.

To make MySpace even "stickier"—and to generate more revenues—Anderson

son and DeWolfe are also working on an eBay-like service that visitors can use to sell tickets and merchandise from their personal pages. Plus, they're busy signing deals with cell-phone companies like Cingular Wireless to put MySpace on handsets. The company gets 70% of the \$2.99 monthly fee that Cingular charges for MySpace service.

MAKING 'FRIENDS'

BUT REALLY cashing will mean reinventing the ad business for the social networking world. Right now, MySpace sells the majority of its ads at rock-bottom rates: an average of \$1.50 or so per 1,000 users vs. \$40 or so for video sites. One way of getting rates up is to create customized ads. The site has shown it can be good at this. One innovation: setting up MySpace accounts for the likes of Pontiac and Burger King, which are used in contests and giveaways to make "friends."

MySpace also aims to enlist users in viral cam-

paigns. Using contests and surveys, plans to identify MySpacers with a ton of friends and a propensity to blather about products they love. "They're influential and power users," says Michael Barrett, chief revenue officer for FIM, which sells ads for MySpace. Barrett, a longtime America Online sales exec, is also building a major league ad sales team—doubling its members to 80 from last year. They have plenty of useful data to help develop a stealthy viral sales pitch. As MySpacers travel the site, they leave behind a wealth of clues about their likes and dislikes. In February, Fox purchased Santa Monica (Calif.)-based Strategic Data Corp., which identifies key characteristics of users (women golfers, for instance) and then makes sure marketers get their ads on pages where those folks go.

MySpace may soon be the profit machine that Murdoch originally envisioned. But getting there involves a tricky balancing act: creating ads that don't alienate MySpacers, some of whom are already fleeing to hipper precincts. ■

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COMMENTARY

BY ROBEN FARZAD

Activist Investors Not Welcome

Icahn's interference at Motorola stands in the way of its mission

FEED ME, ZANDER!" GROWLED the relentless shareholder. Motorola Inc.'s chief executive shouldn't heed the demand. With Motorola's cell-phone business tanking, CEO Edward J. Zander is under intense pressure to create another hit product like the Razr phone, or buy a company that can. Standing in his way is activist hedge fund man-



ED ZANDER

ager Carl C. Icahn, who holds a 2.7% stake and is roaring for ever more cash, in the form of stock buybacks, to be thrown into his fearsome jaws. That puts Motorola at an existential crossroads.

It's one thing for activists to target, for example, a ketchup maker; a mature company that throws off tons of cash would be hard-pressed to argue against kicking some back to shareholders. But Icahn's engagement with Motorola is a different animal. As a high-tech electronics giant, it must invest a lot in research and development, especially as the 79-year-old company confronts slumping sales. Normally activist investors steer clear of such situations. Yet Icahn, who did not return several phone calls seeking comment, wants Motorola not only to hand over its entire \$9 billion cash stash but also to mortgage future cash flows by taking on debt to fund even more buybacks. After the company disclosed Icahn's initial stake on Jan. 30, he called on the board to buy back up to \$15 billion in stock.

Monitoring the Motorola situation no doubt are a slew of aging tech companies with excess cash on their balance sheets that could soon find themselves facing activists. "I'm more concerned about all the management time and energy being spent on this when Motorola has to manage operations, innovate, and invest in research and development at one of the most challenging times in years," says Fitch Ratings Inc. bond analyst Nick P. Nilarp.

Motorola, which declined to comment, shouldn't cave in. Zander steered something of a revival after becoming CEO in 2004, thanks to the once-hot Razr phone and \$6 billion in company acquisitions. Why give up

and gut the balance sheet now? "It would be imprudent to let the cupboard bare to lever up to buy back stock," says a source close to the company. "That's even more relevant in tech, where you need to stay fleet of foot for acquisitions and innovation. Without a balance, you're competitively vulnerable."

Motorola already is. On Mar. 21, the Schaumburg (Ill.) company forecast a \$1.2 billion revenue shortfall and quarterly loss, its first sales decline in four years. Its margin on phones, which make up 60% of sales, plunged from 12% in the previous quarter to 4.4%. Meanwhile, Apple Inc.'s soon-to-ship iPhone and Research In Motion Ltd.'s BlackBerry Pearl are stealing center stage even as Pizza Hut gives away MP3 phones. With the Razr costing a tenth of its \$499 initial price, it's no time for Motorola to starve itself of the cash needed to create the next hit.

Yet Motorola is starting down that dangerous path. In its somber release, it said it had executed an immediate \$2 billion buyback and committed an additional \$3 billion

to future repurchases. Even that won't likely satisfy Icahn, who disclosed a day later that he had raised his stake. A source close to Motorola worries that Icahn is after a major recapitalization where the company takes out a big chunk of debt to fund more than \$20 billion in buybacks.

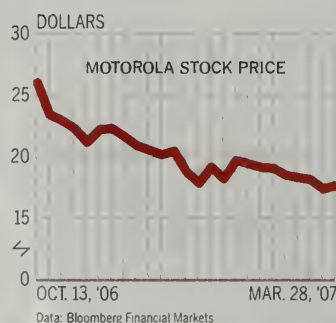
You might expect analysts to be cheering the agitation. After all, as Icahn said in a recent letter to *BusinessWeek*, 10 campaigns have rewarded shareholders large and small. But his demands on Motorola are being met with a blend of puzzlement and irritation. "I never had a problem with

the balance sheet," says M. Casey Ryan, analyst with investment bank Nollenberg Capital Partners. "I wanted them to invest and focus on the high end with a hit phone to build for the future." Ryan says Motorola should resist pressure to defer to Icahn. Adds Zhiping Zhao of research firm CreditSights: "I don't understand why Icahn set his sights on Motorola in the first place. And I don't know if he understands what he's getting into."

Since last July, the company already has spent \$3.1 billion on buybacks. Yet share price has fallen. Does Motorola know what it's getting into? ■

Companies like Motorola need cash to innovate, not just to set buybacks in motion

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LITIGATION

ORACLE VS. SAP: SOUND OR FURY?

Larry Ellison's high-profile charges may be only PR, but that may be all he wants

BY AARON RICADELA

ORACLE CORP. CHIEF Executive Lawrence J. Ellison sure knows how to kick 'em when they're down: On Mar. 22, two days after reporting blockbuster sales of Oracle's business software in a conference call that included potshots at archrival SAP, the company filed suit in a federal court in San Francisco, claiming SAP employees stole 10,000 tech-support files from its computers in a case of "corporate theft on a grand scale."

The suit is the latest shot in the blood feud between tech's fiercest competitors, and it cements Ellison's reputation as a crafty opportunist who exploits rivals' weaknesses. "This is Larry Ellison at his finest," says Marc Benioff, CEO of salesforce.com, a former Ellison protégé. "He is a master at [using] *The Art of*

War"—Chinese general Sun Tzu's sixth century B.C. primer on military strategy, which is much admired by Ellison.

Oracle's 44-page complaint reads like pages ripped from a different sort of book—a spy novel. Oracle accuses top SAP executives of orchestrating a heist to improve their own products and steal Oracle's customers. It alleges that SAP employees posed as Oracle customers, stole passwords, and cached purloined documents on SAP computers. Whether true or not, analysts say the accusations could sully SAP's reputation and crimp first-quarter sales as it tries to bounce back from a recent slowdown. Oracle would not comment.

SAP vows to defend itself aggressively and suggests the suit could be little more than a marketing ploy. "It wouldn't surprise me [that] they see creative ways to attack our business if they don't see a way to beat us in the marketplace," says

Andrew J. Nelson, president of SAP TomorrowNow Inc. unit. Indeed, in spite of Oracle's acquisitions of PeopleSoft and Siebel Systems, its estimated 12% market share in corporate application software last year is about the same as the totals of the three before they merged, according to industry consultant AMR Research. Meanwhile, SAP's share climbed from 19.5% in 2004 to nearly 22% in 2006.

'CIVIC DUTY'

ELLISON HAS A LONG history of launching attacks to disrupt another company's business. Three years ago, when Oracle announced its hostile bid for PeopleSoft, analysts saw it as a way to weaken, and then pick off, a vulnerable rival. In 2000, Ellison hired private investigators to rif through the trash of trade groups sympathetic to Microsoft Corp., calling it his "civic duty" to do so. More recently, SAP has been in the bull's-eye. Two years ago, Oracle swiped retail software maker Retek Inc. from under SAP's nose after a heated bidding war.

SAP doesn't pull its punches, either. Its TomorrowNow acquisition, which came just as Oracle was closing on its purchase of PeopleSoft, was seen by analysts as a way of undercutting Oracle. TomorrowNow sells support for software from PeopleSoft, J.D. Edwards, and Siebel Systems—all three now part of Oracle—at half price. About 300 customers have signed up for the service, which offers fast phone support and updates that keep software current with regulations. The business has become the keystone of a successful program to get Oracle customers to switch to SAP.

"Oracle is starting to feel the hurt of having TomorrowNow take its customers," says Joshua Greenbaum, principal at Enterprise Application Consulting.

Now the question is whether Oracle can prove the alleged SAP downloading—if it indeed occurred—was ordered by executives and wasn't just a rogue operation. There's nothing in the complaint that directly connects SAP's tech dogs to the downloads. "It's not going to be an easy thing to prove," says Yar R. Cherkovskiy, a partner at Sonnenschein Nath & Rosenthal. But "there'll be a market effect now—negative PR for SAP," he says. And that may have been the point. ■



JANUARY, 2005

SAP purchases TomorrowNow, a company that sells cut-rate tech support for a variety of Oracle products.

MARCH, 2005

Oracle says it will buy retail software maker Retek for \$630 million, swiping the company from SAP after a bidding war.

JANUARY, 2007

SAP says it's signed up 485 customers for its "Safe Passage" program, which offers discounts to companies that switch from Oracle.

MARCH, 2007

Oracle sues SAP, charging "corporate theft on a grand scale" and alleging SAP downloaded Oracle tech-support data.

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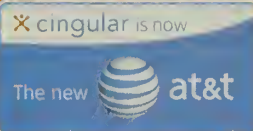


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SOCIAL POLICY

RUSSIA'S NEW DEAL

The Kremlin is pumping money into education, housing, and health care

BY JASON BUSH

FOR 20 YEARS, HEADMASTER Alexander Korovin has struggled to keep his school humming. The 75-year-old Gymnasium No.35 in Ekaterinburg, an industrial city 900 miles east of Moscow, was crumbling. Budgets were tight, his 115 teachers were paid a pittance, and there was little money left over for extras such as computers, science labs, and sports equipment. But lately things have gotten a bit easier for Gymnasium No.35. Thanks to a 1 million ruble—\$38,000—grant from the Russian government, Korovin has been able to expand the opportunities for his 1,300 students, aged 7 to 17. “Now that we have financing, the school’s facilities have improved dramatically,” he says, showing off the new computers now in every classroom. “The attitude toward education has changed.”

Gymnasium No.35’s newfound fortune is part of Russia’s so-called national projects. For the first time since the collapse of Communism, the Kremlin is making a bottom-up effort to improve the lot of ordinary Russians. In September, 2005, President Vladimir V. Putin identified health, education, agriculture, and housing as priority areas requiring billions of dollars of extra state funding. The aim, he told a special meeting of the Cabinet at the time, is to “invest in people” and create “a substantial increase in the quality of life for Russia’s citizens.”

With parliamentary elections looming in December and Russia’s next presidential ballot due the following March, the government is focusing on vote-winning social issues as never before. Almost daily, state-controlled television gushes about the latest initiative to help regular folk, from pregnant mothers to underpaid teachers. The public face of this new caring-and-sharing Kremlin is Deputy Prime Minister Dmitry Medvedev, Putin’s national projects supremo and a longtime adviser. Once an obscure bureaucrat, Medvedev, 41, has in the past year become one of Russia’s best-known public figures as he crisscrosses the country visiting hospitals and housing projects. That’s playing into Kremlin politics: Medvedev is one of two men that Putin seems to be grooming as potential successors. (The other is Deputy Prime Minister Sergei Ivanov, who is revamping the defense industry.)

Many Russians see the Kremlin’s social policy blitz as short-term vote-grubbing that won’t end up helping the people. In an opinion poll published in September by the Levada Center, a Moscow research institute, 58% of respondents said they believed the national projects were unlikely to have a significant influence on their lives. Only 29% thought the efforts

Skeptics say the spending blitz is just vote grubbing

would make a difference. The same poll found that 47% of Russians believed that the money allocated for the projects would be misspent, and just 13% thought it would be spent well. “It’s all just empty words,” grumbles Elena Makova, a translator and resident of Ekaterinburg.

Such skepticism is hardly surprising in a country used to disappointment. The “shock therapy” economic reforms of the 1990s left a bitter legacy as a handful of tycoons became billionaires while schools and hospitals fell into disrepair. But unlike many politicians elsewhere, Putin isn’t making promises with money he doesn’t have. Oil and gas exports reached \$170 billion last year, up from just \$28 billion in 1998. Federal tax revenues rose from \$4 billion in 2000, the year



CLASS BREAK
Facilities are improved in Ekaterinburg

ЛИСТЫ ГИМНАЗИИ



utin became President, to \$240 billion in 2006. And economic growth has averaged 6.8% annually since he took office.

JUST TO BOOM

YKATERINBURG OFFERS a micro view of the social challenges facing Russia. Surrounded by thick pine forests near the Ural Mountains, the city of 1.3 million is the capital of Sverdlovsk, a territory about the size of Nebraska. Near the center of Ekaterinburg, a recently built cathedral marks the spot where the last tsar, Nicholas II, and his family were killed in 1918. During World War II, the city became a center for the defense industry when 50 big factories were transferred there to escape the invading Nazis. Manufacturing continued to flourish in Ekaterinburg during Communism, but in the 1990s the city's defense, metallurgical, and heavy-equipment plants were struggling to survive market reforms, and a bankrupt Russian government

failed to pay wages and pensions for months at a time.

In recent years, the pendulum of fortune has started to swing back again. Signs of growing wealth are everywhere. Cranes now dominate the Ekaterinburg skyline, as new offices, shopping malls, and apartment buildings rise. Imported cars clog the icy roads, and colorful billboards and banners plug everything from new mobile phones to the latest sushi restaurant. The growing middle class throngs to stores run by the likes of IKEA, Germany's Metro, and the French supermarket chain Auchan.

Yet travel a few miles east toward Siberia and the new construction soon gives way to a snowy landscape of forests and fields, dotted by run-down wooden villages. Near the highway, a lone anti-aircraft missile points skyward: a Cold War monument (still a source of local pride) that marks the spot where the Soviets downed American pilot Gary

Powers' U2 reconnaissance plane in 1960. An hour outside of Ekaterinburg and it's time to take the turn to Sukhoi Log, a bleak town of 36,000 whose name means Dry Gulch.

Instead of traffic jams and trendy restaurants, Sukhoi Log boasts smoke-belching metallurgical, cement, and asbestos mills. Gray Soviet-era apartments line the snowy roads, and the only ads are for the local industrial plants. But one bright spot is School No.1. Sure, on the outside it's just another concrete compound. Inside, though, students are busy working on history, literature, and science projects using new computers and broadband connections recently provided by the state free of charge. "It's a big step forward," says Andrei Rozhnov, 16, who researched underground literature in Russian and English over the Net. "We're no longer so isolated from the world."

Many other schools are also log-



DIVERGING VIEWS Vlasov (above) is disgusted with new apartments going up. But Sivkov is upbeat about his prospects at Patrushy dairy complex



ging on. By the end of this year, the government aims to provide free high-speed Internet to all of Russia's 60,000 schools, and 3,000 will benefit from million-ruble grants for technology and training. Meanwhile, Russia's 10,000 best teachers (out of 1.5 million total) will get awards of \$3,800 each—a welcome bonus on top of salaries that average just \$260 a month nationwide. “At last our government is starting to pay attention to us and encourage us,” says Nataliya Vlasova, a math teacher at Gymnasium No.35.

AIDS RELIEF

EKATERINBURG'S HOSPITALS and clinics are also benefitting from the Kremlin's largesse. In Sverdlovsk, the health projects are belated answers to the demographic crunch hitting the region. Despite the economic rebound, deaths outstripped births by a margin of 19,000 last year—part of a nationwide trend that has seen the population fall by 4%, to 143 million, since 1991. Poor health means that life expectancy in the region is just 63 years, vs. 66 for the nation as a whole. And AIDS is reach-

ing epidemic proportions: Some 4% of people between 20 and 29 in Sverdlovsk are infected with HIV, local doctors say.

The depth of the problem becomes clear when you step inside the Sverdlovsk regional AIDS clinic, a dingy house on a quiet street near the center of Ekaterinburg. Peeling wallpaper and loose floor tiles suggest that the fight against AIDS hasn't been a high priority. Until last year, the clinic lacked drugs for treating HIV, which cost \$10,000 a year for each patient. Today, after a cash infusion from Moscow, the clinic has enough medication for its 700 patients, plus a new laboratory and funds to repair the premises. “We simply sighed with relief,” says Galina Fedotova, the clinic's deputy director. “The first question that we get when we provide the diagnosis is: How long do I have left to live? And now we can answer: You'll live a long time, because we have medicine.”

The AIDS clinic isn't the only health-care facility in the region getting the state's attention. Hospitals have received

115 new ambulances and more than 6 X-ray machines, and the government has doubled the pay for general practitioners, to an average of \$920 a month. Now there's a big push under way to set up 250 clinics in smaller communities throughout Sverdlovsk.

That's because Russia's most serious social problems are often concentrated in the country's far-flung villages. About half of Sverdlovsk's 600,000 rural inhabitants are over 60 years old. Farmers in the region earn an average of \$230 a month, and most young people deserted the villages long ago, attracted by greater opportunities in the city. Still, not everyone is flocking to the bright light anymore. Evgeny Sivkov, 28, has chosen to stay at the Patrushy dairy complex, cluster of modern blue buildings housing 1,800 cows. The \$12 million complex was built by a local mining company using subsidized credits under the national projects. While only 21 people work on the farm, Sivkov says locals welcome such investments because they provide

Investing in **Russia's** People

The Kremlin is pouring oil wealth into long-neglected social programs*

HEALTH

\$6.4 billion

- Doubling pay for family doctors, to an average of \$750 a month
- New X-ray machines, labs, and ambulances for hospitals
- Grants of \$270 to new mothers for prenatal and child care

EDUCATION

\$3 billion

- \$1.1 billion in grants to innovative schools, teachers, and pupils
- Internet connections for all 60,000 schools by yearend
- \$130 million for new buses and equipment in rural schools

HOUSING

\$1.7 billion

- Loan guarantees and subsidies for apartment and house builders
- Encouraging home loans via a state-backed mortgage agency
- Paying up to 40% of the cost of new homes for young families

AGRICULTURE

\$1.7 billion

- Funding interest payments on loans to small farms
- \$300 million in new capital for a state agricultural bank
- Subsidizing up to 70% of housing costs for 30,000 farmers

*All spending over two years, 2006-07

Data: Russian government

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etter pay and new chances for young people. He now earns \$765 a month as an manager, double the salary in his previous job raising calves. "It's interesting for me," Sivkov says. "You need to raise our level and learn something new."

LONG, SWING SETS

ACK IN THE BOOMING city, there's no shortage of new jobs. Ekaterinburg's bigger problem is the struggle to provide homes for its citizens. That's one reason Putin's fourth national project aims to build affordable housing. Ekaterinburg has more apartments than ever as subsidized mortgages and state guarantees help fund new construction. Last year the city's housing stock jumped by 14%, the fastest pace ever, boasts local construction minister Alexander Karlov. "The authorities are working so that the population lives better," he says.

But real estate prices have also doubled, and the breakneck development has angered some residents. In northern Ekaterinburg near the giant Uralmash heavy-equipment factory, pensioner Ivan Vlasov stares in disgust at the area behind his building. Once a leafy enclave with swing sets and park benches, it's being dug up to make room for a 250-unit apartment complex. Led by Vlasov, the neighbors have formed a protest committee to fight the project in court, arguing that the city failed to hold an open auction before it sold the land. "Back in the '50s, Khrushchev made a lot of promises, and then Gorbachev said that everyone would have an apartment by 2000," Vlasov says. "But we still have huge housing problems."

Such opposition is a reminder that, despite the heady economic growth of recent years, many Russians remain dissatisfied.

Still, the remarkable life-lift for schools, hospitals, farms, and communities in the Sverdlovsk region suggests there's more to Putin's social programs than empty promises. And among direct beneficiaries, such as the students of Ekaterinburg's Gymnasium No. 35, skeptics are few. "I think for Russia has a good future, especially now that the state is caring about its people," says Irina Afingoeva, 16, a pupil at Gymnasium No. 35 who wants to become a lawyer. "At least, we really hope so." ■



YOUNG CONSUMERS Muji targets shoppers who appreciate modern design

RETAILING

ZEN AND THE ART OF SELLING MINIMALISM

Muji, Japan's Ikea-cum-Target, is set to bring its stripped-down, no-brand chic to America

BY KENJI HALL

IT SELLS SLEEK AND FUNCTIONAL designs in a spare retail setting. Its prices can't be beat. And it has legions of fanatical devotees. Ikea? Nope. It's Muji. Though few Americans know it today, that may soon change.

Muji's full name, Mujirushi Ryohin, translates into "no-brand quality products." This fall, the store is heading to the U.S. in hopes of wooing Americans tired of in-your-face logos and over-the-top design. "To us, it's all about a product that's simple and functional," says Tadamitsu Matsui, chief executive of Muji's parent company, Ryohin Keikaku Co. "Once you remove the price tag from our products, there's nothing to indicate what the brand is."

But Muji isn't just another generic brand. Its post-industrial designs tap into the less-is-more esthetic visible in Japan's temple gardens and haiku. Larger Muji outlets carry more than 7,000 products that run the gamut from \$4 striped socks to a \$1,170 front-loading washer-dryer combo. There's even a line of prefab houses that start at \$115,000.

Muji already enjoys plenty of fans overseas. The company has 387 outlets in 15 countries, including 34 stores in Europe, and has been adding a dozen or more annually in recent years. To date its only U.S. presence has been at the New

York Museum of Modern Art (MoMA), where its \$8 aluminum business-card holders and \$42 collapsible cardboard speakers have been a hit. Muji estimates net profit for the year ended in February rose 9.4%, to \$90.7 million, on a 14.5% increase in sales, to \$1.3 billion.

The question is whether Muji's celebration of the ordinary will play well stateside. The Japanese retailer will be taking on heavyweights: Ikea and Crate & Barrel in furniture, Gap in apparel, and Target in housewares, which cater to Muji's intended audience of consumers in their 20s and 30s. Although Muji hasn't yet determined what it will charge for its wares at a new 5,000-sq.-ft. store in midtown Manhattan, its prices at MoMA's two stores are roughly double those in Japan. Muji "will have to carve out its own place," says David Marra, a retail consultant at A.T. Kearney Inc. in Tokyo.

Muji's chief is treading carefully. He expects the New York store to turn a profit within a year; outposts in Boston, Chicago, and San Francisco might follow. While Muji is riding the same Japanese pop-culture wave that has landed retailers such as Uniqlo in New York in the past year, Matsui believes his brand has staying power: "Muji's roots are Japanese," he says. "But we think our products will appeal for their simple, universal designs." ■

—With Elizabeth Woyke in New York



Is Google too powerful?

As the Web giant tears through media, software, and telecom, rivals fear its growing influence. Now they're fighting back.

BY ROBERT D. HOF
ILLUSTRATIONS BY SAM WEBER



Making Sense of Google

As Google releases blizzards of new services, aggregates more data, and bursts into new industries, it becomes harder to wrap your mind around what exactly the company is—and, more important, what it may become. Clearly, it's more than just a search engine. Any one of, or combination of, the following scenarios is possible:



WHERE GOOGLE
MAY BE HEADED

World's Biggest Computer

Web sites aren't just places to go online—every click a user makes is a command for some computer somewhere. Nobody has more options at its command than Google, which just introduced an online suite of office productivity programs. Soon, Googling will mean far more than just searching. It'll mean getting almost anything done online.

IT'S THE YEAR 2014, AND GOOGLEZON, A fearsomely powerful combination of search engine Google Inc. and online store Amazon.com Inc., has crushed traditional media to bits. Taking its place is the computer-generated Evolving Personalized Information Construct—an online package of news, entertainment, blogs, and services drawn from all the world's up-to-the-minute knowledge and customized to match your preferences. And it's all collected, packaged, and controlled by Googlezon.

This is the future according to *EPIC 2014*, a faux documentary posted to the Web in late 2004 by young journalists Matt Thompson and Robin Sloan. Thanks to their slightly tongue-in-cheek, *Twilight Zone*-inspired tone, the short video drew as many chuckles as gasps of dismay from the legions of mainstream media types and Web digerati who viewed it. Today, nobody's laughing. Here it is only 2007, and already *EPIC 2014*'s picture of an online landscape dominated by one ravenous, all-knowing corporation looks to many people like—well, a lot like Google. All by itself.

That simple little search box we all use every day? As the place nearly 400 million people each month start on the Internet, it's the No. 1 gateway to the Net's vast commercial potential. With more data on what people are searching for, Google can serve up the most targeted and relevant

advertisements alongside the results, drawing more clicks, more cash, more users—you get the idea. Consumers love Google's simplicity and results, which is why it draws 56% of all searches. No wonder eager advertisers shoveled some \$10.6 billion into Google's coffers last year, up an astonishing 73% from 2005. If you can believe it, Google's \$144 billion market value tops that of Time Warner, Viacom, CBS, ad agency giant Publicis Groupe, and the New York Times Co. combined.

To the consternation of many of those companies and more, Google is now using that market cap, along with its \$11 billion hoard of cash and investments, to storm a wide range of traditional markets. It's selling ads in newspapers, magazines, radio, and, in a trial program, television. In February it fired a torpedo at the software industry with a suite of online office software it is selling for a small fraction of the price of Microsoft Corp.'s Office. It's spooking the telecom industry with fledgling efforts to provide free wireless Internet access. Google's phenomenal ad machine, short, has the potential to vaporize the profits of any industry that traffics in bits and bytes and to shift the economics to the advantage of Google, its users, and its cadre of partners. "It's Google's world," shrugs Chris Tolles, vice-president of marketing at Topix Inc., which makes money from running Google ads on its news aggregation site. "We just live in it."

Googlezon, GoogleWorld, just plain Google—whatever



WHERE GOOGLE
MAY BE HEADED

The Better Internet

Google continues to expand its massive server farms and its fiber-optic capacity, its system could in essence come to serve as an alternative network that mirrors the whole Internet but runs faster. Why would you want to click anywhere else?

You call it, it's scaring the wits out of everyone from the power brokers of Hollywood to Madison Avenue ad moguls to Silicon Valley entrepreneurs. Now, after years of hand-wringing and thumb-twiddling, some of them are pulling out the heavy artillery and firing one round after another on the Googleplex, the company's headquarters in Mountain View, Calif. The latest salvo: On Mar. 22, NBC Universal and News Corp. announced plans (page 22) for a rival to Google's enormously popular YouTube video site that will run not only television show clips but even full-length movies on Yahoo!, AOL, Microsoft's MSN, MySpace.com, and other partner sites.

Just the week before, Viacom sued Google for a headline-grabbing \$1 billion, charging YouTube with willfully infringing on copyrights by allowing users to upload clips of *The Colbert Report*, *South Park*, and other TV shows. A couple of weeks earlier, Copiepress, a group representing Belgian and German newspapers, won a copyright case that could sharply limit Google's usefulness if it sets a precedent. And get this: In the Valley and Washington, D.C., there's an open cocktail party chatter about whether the search giant's power needs to be reined in by antitrust regulators. It's unlikely to happen but is an indication of rivals' growing epiphany about Google. Says Paul Martino, chief executive of the search service Aggregate Knowledge Inc.: "We're

beginning to see the 'Anything But Google' backlash."

And something bigger. Google is ground zero in a battle among traditional media and tech industry leaders and startups alike for the hearts and minds of the world's consumers—or at least their eyeballs and wallets. To an extent that none of the first generation of dot-coms did, Google has come to represent all our hopes, dreams, and fears about the disruptive promise and dangers of the Internet. As this clash plays out over the next couple of years, the outcome could determine the way we'll entertain ourselves, shop, socialize, and do business on the Internet. The overriding question: Will the vast commercial landscape of the Net, like so many other tech markets in the past, condense to one dominant force for the foreseeable future? Will we just Google everything?

All this might sound crazy given that we're talking about a nine-year-old company that wasn't even publicly traded until Aug. 19, 2004. Let's face it, there's a certain hysteria about Google, a presumption of unlimited power. A year ago, Google was rumored to be going into the personal computer manufacturing business, and last week stories about a Google cell phone ran rampant. Neither was true—nor, says Google, are a number of other assumptions. "We're not competing with newspapers, we're not competing with television stations, and we're not competing with the Viacom of the world," insists Google Chief Executive Eric E. Schmidt. "We're trying to partner with them."

What's more, some of Google's initiatives, such as those in print and radio ads, have not taken the world by storm. Yet to justify that market cap, Google must expand into more densely occupied markets for continued growth when online advertising matures. "Google needs an Act II," says Jordan Rohan, an Internet analyst at RBC Capital Markets. "Otherwise, the growth is going down to 30%" in the next few years.

The question now: Does the pushback against Google mark that turning point when a successful company's power starts to work against it? Could be. "Ecosystems always organize to curtail entities that get too powerful," notes Geoffrey A. Moore, author of *The Gorilla Game: Picking Winners in High Technology* and a managing director at corporate strategist TCG Advisors. As a result, Google

may need to change some of its more aggressive tactics to ease the fear it engenders. Says Jeremy Crane, director of the search group at Web information service Compete Inc.: "A lot of people are rooting for others to provide alternatives."

But for now those alternatives, whether they be a struggling Yahoo or Microsoft or the new NBC-News Corp. video network, by all accounts pale next to the Google juggernaut. More than anyone else, Google is defining the new architecture of media

GOOGLE BY
THE NUMBERS

\$144
BILLION

Google's stock
market
capitalization

Data: Bloomberg
Financial Markets

and commerce in the digital world. The unruly expanse of the Internet and its opportunities cries out for a map, and that's what Google is building out of tens of thousands of server computers around the world that handle quadrillions of bytes of data. With each new search whose data refine that map, with each new business that links its own digital explorations to the search engine, Google gains more knowledge and more power. As a result, it's in a position not only to define what this new world looks like but also to chart where it goes and even determine which will be the prime destinations and which will become backwaters.

This awesome data-gathering capability seriously worries some thinkers. Tech historian George Dyson, author of *Darwin Among the Machines: The Evolution of Global Intelligence*, thinks Google actually might pose a national defense concern at some point simply by virtue of its singularly massive storehouse of data, the crude oil of the Information Economy. "That much money and power concentrated in one place can be dangerous," says Dyson, who sometimes advises the Defense Dept. on potential threats. While he doesn't think Google yet poses such a threat, he raises a more obvious concern: Google's vast network, now a substantial piece of the Internet itself, is "very quickly becoming vital national security infrastructure." Should anything happen to the company, he says—through market forces, terrorist attacks on server farms, or something else—that could compromise national defense.

If this talk of corporate dominance sounds vaguely familiar, it should. As firmly as IBM ruled mainframe computing and Microsoft the personal computer age, so Google has the potential to rule the Internet. To some people, Google's position today, while clearly far from identical to

Microsoft's in its heyday, nonetheless shares some striking parallels. "Google feels a lot like Microsoft in the mid-Nineties," says Silicon Valley startup adviser Dave McClure. "Right at the height of its power, getting a little arrogant, and challenged for the first time by some powerful people."

Even mighty Microsoft has been criticizing Google's power and ambitions. CEO Steve Ballmer last fall accused Google of suppressing competition in online ads. As rich as the irony of his



**WHERE GOOGLE
MAY BE HEADED**

A Living Machine

To hear some people talk, Google could morph into something out of the dystopian darkness of *The Terminator*. Does the Google grid, once it comprises millions of machines analyzing the whole of human existence, at some point become sentient—for all appearances, a thinking machine?

accusation is, given Microsoft's own antitrust battles, the charge isn't unique. Google's mission to "organize the world's information and make it universally accessible and useful," so charmingly visionary in a startup, now sounds to some people downright predatory in a company of nearly 12,000 employees. Google even worries partners such as Time Warner, whose AOL unit in late 2005 took \$1 billion from Google for a 5% stake and the right to run ads on the service. "Obviously, Google has a great deal of power, and it needs to be very careful not to leverage that power to stifle competition," says Paul T. Cappuccio, executive vice-president and general counsel at Time Warner Inc.

Naturally, none of this criticism sits well with Google executives. The company, they note, has a commanding position solely because users and customers like Google's services, not because they're forced to use them. "To say Google is too powerful implies that users are somehow making a wrong choice," says Schmidt, who calls the comparison to Microsoft "absolutely false." Unlike with Microsoft's software, anybody can click instantly to a new search engine if it's better—just as people abandoned AltaVista and Yahoo for Google years ago.

Few people, even Valley leaders who have faced the dominance of Microsoft firsthand, suggest that Google needs to be checked by government regulators. "Does ad-subsidized software threaten legacy businesses? Of course," says Jonathan Schwartz, CEO of Sun Microsystems, "just like...eBay threatens Sotheby's and Amazon threatens Wal-Mart. But last I checked, these are all examples of competition, which we want in America. It's the heart of progress. It's good for consumers." And for Google's partners. Says Marc Benioff, the CEO of one such partner, customer management services provider Salesforce.com Inc.: "Google has really stepped up and defined what the future of our industry can be."

Moreover, there's little evidence that users have any problem with the company's power, even if they don't all take its informal motto, "Don't be evil," at face value. These fans might be excused for tossing back their own question to the whiners: Too powerful at what? Helping me find things, get work done, connect with friends? Bring it on!

For most of us, then, complaints about Google's power

GOOGLE BY THE NUMBERS

31%

Google's share of U.S. online advertising revenue (October, 2006)

Data: Morgan Stanley

Too Powerful? Us? Surely You Jest

Google Inc. CEO Eric E. Schmidt knows something about facing powerful companies. As chief technology officer of Sun Microsystems Inc., he was deeply involved in that company's battles with Microsoft Corp. When he left to become CEO of Novell Inc., Schmidt again was pitted against the software giant. So the suggestion that the leader in Internet search might be getting too powerful strikes a chord. Here's an edited version of his talk with Robert D. Hof:

Q: Is Google too powerful?

A: Too powerful relative to what? I mean that as a question, not as a statement. This is all about user choice. And the studies that I've seen indicate that a majority of users are choosing Google to get information. That's great. We could lose that in a nanosecond. This is not like proprietary lock-in models, where users are forced to use Google.

Q: Why do you think some people are complaining about Google's power?

A: Try to understand the motivations of the complainers. Google is one of the companies where advertising is moving to us and from other forms of media. The fact of the matter is, that's about the Internet, not about Google. We are one of the companies, but we are certainly by no means the only one.

I think that the resentment—and what I think you're really describing is resentment—may come from the fact that we have been fortunate in that our model allows us to innovate more quickly and solve problems more quickly. I'm not suggesting we're 100% perfect. But I think on average, we're executing quicker.

Q: I think that gets at some of the fear and anxiety—people are uncertain where Google goes next.

A: I'll give you an example. We have a large private network of data centers. And we needed to hire an engineer who was a wavelength division multiplexer engineer—WDM is the technology used in high-speed fiber networks. So

based on this, it was reported that we were going to compete with the long-distance carriers and become a telephone company, which caused the CEOs of Verizon and AT&T to announce that we were their No. 1 competitor.

Q: People compare Google to Microsoft in the mid-1990s—at the height of its power, arrogant at times.

A: The comparison is absolutely false. Microsoft had 90%-plus market share in a market where it was impossible to switch. Google has neither.

Q: Does the perception of Google's strength require the company to operate any differently? Last year you mentioned an increased emphasis on partnerships.

A: That's not why we do these things. It became obvious that we needed to expand our partnership strategy a year ago because it was the right thing. It did have a defensive property. But one of the ways in which I know we're doing well is that we spend our time focusing on what we're doing and what we can do that's new rather than obsessing about competition.



SCHMIDT
"This is all about user choice"

Q: Why do people assume Google is going to compete in so many areas?

A: It's part of a mystique. The mystique serves us in recruiting but does not serve us in partnerships. So it's better if we moderate it. We're not competing with newspapers, we're not competing with television stations, we're not competing with the Viacom of the world. We're trying to partner with them.

Q: But aren't you competing at least as a distribution channel?

A: Only in the distribution channel sense. There's always this assumption that somehow Google will now take over all of advertising. It's clearly false, because advertisers choose all of the channels that people do, not just one.

Q: Some smaller advertisers feel they're getting left behind as big brand marketers move into search marketing and price them out. Is that something Google needs to address, since so many of its advertisers are small businesses?

A: It's funny, because I hear the inverse. What I hear from the large advertisers is that they're used to having their way. They're not used to having to deal with those smaller advertisers, who at least have the potential in an auction at having an equal shot.

Q: Is there some point at which Google becomes subject to the cyclicity of the ad industry?

A: I'm sure that we will eventually be subject to the cyclicity. But we are not now. And "eventually," I have no idea how many years that is.

Q: Is Google really creating a true artificial intelligence, or thinking machine, as Google's founders have set as a goal? That gives some people the willies.

A: That's because they're using broad and imprecise terms. Our spelling correction [on misspelled search queries] is an example of AI. But in the next few years, cognition, or real understanding, remains a research dream.

might smack of sour grapes, or at least corporate power politics. Fact is, a couple of Stanford University nerds, Sergey Brin and Larry Page, devised a much better way for people to find things online, stealing a march on media and tech companies too busy or too dumb to notice the transcendent power of Internet search. By charging advertisers only when people click on their ads, Google gave advertisers a good chunk of the 50% of ad spending wasted in traditional media. Indeed, a huge swath of small businesses that never could afford to advertise nationally or globally—the majority of Google's customers—now can, through search ads.

Those aren't Google's only friends, either. It enables thousands of small Web publishers to make a living by paying these publishers, to the tune of \$3 billion last year, to run syndicated ads. Cincinnati's AskTheBuilder.com pulls in more than \$1 million a year, says founder Tim Carter, thanks largely to income from Google's syndicated ads that run on his home how-to site. He understands why Google worries Viacom and others, because when people are looking for almost anything online, "they go to Google first. You bet those companies better be terrified." But as long as folks like Carter get a free lunch from Google, they don't much care if it's eating everyone else's.

Google maintains a glow of goodwill among many for yet another reason: Since its founding at Stanford in 1998, it has become one of those rare icons of the tech business, like Apple or Hewlett-Packard. Google's success is helping to drive a whole new round of technology innovation and wealth creation, including hundreds of so-called Web 2.0 companies whose business model is revenue from running Google ads. In the process, it confirms the Valley's creation story: Anyone has a chance to change the world and get fabulously rich. "Google, with its 'Do no evil' mantra, its democratic values, its employee benefits, attention to the culture, and two decent co-founders, is the new HP," says Jeffrey Pfeffer, a professor of organizational behavior at the Stanford Graduate School of Business. "At least in people's dreams."

But Google's dreams are the stuff of nightmares for some folks in the worlds of media and technology. Most of all, they're uncertain about what Google will become next. It doesn't help that Google itself has



WHERE GOOGLE
MAY BE HEADED

Media Mogul

Since it bought YouTube, Google has firmly placed its stake in the ground: It won't be just a place that connects people to other sites but a distributor of video content, for starters. That is, if it can learn to play nice with the media companies it has ticked off.

long fed those anxieties with its lofty aspirations. Indeed, its embrace of the primacy of data over human judgment, in everything from its search algorithm to its attempts to turn hiring into a science, gives some people the creeps. Listen to a tall that Page, Google's co-founder and president of products, gave in 2002 at Stanford. He said Google aims to turn the technology behind its search engine into a true artificial intelligence that could "answer any question, which means you can do basically anything." The audience laughed tentatively, perhaps thinking of the AI in the movie *The Terminator* that tries to wipe out humanity. If Google succeeds in its mission, Page added with a grin, "then we're doing everything."

The fear factor first came into public view over copyright issues, when Google began digitizing millions of books at various libraries starting in 2004. The company built scanning machines from scratch and hired workers to run them. Still in test mode, Google Book Search, which includes both the library project and separate agreements with publishers, lets users search for words within the books it plans to scan. Searches bring up a table

of contents and snippets containing the words; publishers can agree to make sample pages available.

The problem was, Google chose not to ask publishers' permission before it launched the library project, claiming that copying books to provide snippets of text in searches was fair use under copyright law. And it took few pains to ease publishers' concerns: Why would people buy a whole book when all they need is a few paragraphs from a simple search? If that's what potential buyers end up doing, Google destroys their whole economic model. As a result, the Authors Guild and a group of publishers, including *BusinessWeek* owner The McGraw-Hill Companies, each filed lawsuits in 2005 against the library scanning project, charging that it violates their copyright. Sheryl Sandberg, Google's vice-president for global online sales and operations, concedes that "maybe we didn't realize some people were scared." Google is now making overtures at publisher gatherings.

Still, Google, like others such as Amazon.com Inc. that also are scanning books, contend that their main impact is to expose to the public books they never knew existed, which they believe will prompt more sales, not less. In any case, Google isn't backing down from its

GOOGLE BY THE NUMBERS

56%

Google's share
of Net searches
(February,
2007)

Data:
Nielsen//NetRatings

Contact us at 1-800-PORSCHE or porscheusa.com.

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When do you tell it that it's not a sports car?

From conception it blurred the line between practical and thrilling. To that add a more muscular stance and a new, more powerful engine that heightens performance but uses less fuel. Perhaps some things are better left unsaid. Porsche Cayenne. There is no substitute.

The new Cayenne. Starting at \$43,400.



PORSCHE

position that its scanning is simply creating a digital library. "We're willing to fight for end-users consistent with the way we believe the law is written," says Schmidt.

It's in the advertising business that Google's presence causes the broadest concern. That's because it has been hugely successful in refining the idea of targeted advertising so far beyond conventional media and even direct marketers. What really raises Madison Avenue's hackles is the potential for Google to become Universal Advertising Inc.: a sprawling presence that brokers highly targeted ads across all media. By reading the intentions of hundreds of millions of consumers—not just from its search engine but from, say, cable set-top boxes that can gather similar data—Google could become the most efficient aggregator of ad dollars. The fear is that in the end, a Procter & Gamble Co. will simply turn over its annual ad budget to Google, which will dole it out to wherever the most lucrative consumers are. Essentially, Google becomes the nexus of all advertising and media.

That fear isn't entirely rational, of course. Schmidt insists that Google is neither seeking nor will capture a lion's share of the ad business. "There's always this assumption that somehow Google will now take over all of advertising," he says. "It's clearly false, because if you're an advertiser, you're going to go to all of the people, not just the No.1 player." But the fact remains that a disproportionate amount of the riches go to the No.1 player. Says Kevin Lee, executive chairman of Did-It Search Marketing: "Half a million or more Google advertisers are ready to give them more money." Google's riches are yet another competitive weapon



WHERE GOOGLE MAY BE HEADED

Ad Exchange

It's now clear that Google's ambitions extend well beyond those four-line text advertisements, lucrative as they may be. It could wind up creating something like a NASDAQ for all ads, applying the efficiency and measurability of search ads to radio, print, and television.

that rivals fear. For startups, Google and its nearly unmatched financial might is the yin and yang of Valley entrepreneurship. The company is an inspiration and a potential buyer. But it also can close down a nascent market niche with the merest rumor that it might jump in.

With that kind of influence, coupled with a lack of an obvious, significant failure to date, it's not surprising that Google and its employees exude an air of arrogance. Yet this posture is also becoming more of a liability. Last fall, for instance, it looked as if the wrangling over commercial clips appearing on YouTube without permission would be quickly solved by Google greasing some Hollywood palms. But according to people close to the talks, potential deals soon broke down on multiple fronts. Those sources say that Google offered several hundred million dollars over five years to license a broad range of content. But Google kept reducing its offer, they say, and insisted on controlling ad sales, including getting a third of the proceeds. Finally

take to heart

take to task

Google refused to filter YouTube for copyrighted content. Google declines to comment on negotiations.

Soured talks may have led to Google's getting left out of the group of initial partners in the new online video network coming from News Corp. and NBC—which NBC Universal CEO Jeff Zucker calls the biggest new advertising platform in the world. Google may be in the unaccustomed position of having to crawl back to Hollywood with hat and checkbook in hand to get access to the content. A source close to the situation says Google will probably be forced to accept a far smaller cut of advertising revenues than what it initially asked for.

Even some of Google's advertising customers complain that the company sometimes appears cavalier about their concerns. That's partly because of the very technology on which it's built. Its search-ad business

runs on a pointedly opaque set of complex mathematical formulas that give high placement to ads based not simply on which marketers pay the most but on how many people click on them and other factors. That prods advertisers to create better ads and more relevant Web pages to which the ads send them. But such a system leaves advertisers to guess which ads work best and how much to pay for ad placement, and the ranking can change without warning. "Yeah, they say they're not evil, but you have to trust them," says Anil Kamath, chief technology officer at Efficient Frontier, which helps advertisers run search ad campaigns. "It's difficult for advertisers to figure out what's going on."

The secrecy surrounding the "black box" of search advertising remains particularly galling to some advertisers when it comes to the issue of click fraud. That refers to an array of schemes by which nefarious Web site operators generate fake clicks on Google ads to make money or hurt competitors. Until recently, Google said only that it believed the incidence of click fraud was very low. Some advertisers believe Google ignored their claims. In early March the company released more data on click fraud and said it would offer more tools to combat it.

Between the company's growing power and influence and the perceived attitude problems, Google may face stronger opposition as it expands its horizons beyond search. "Google's power and size and profitability and prosperity have hurt them as they go out and negotiate

with these entertainment companies," says Jeff Lancot, senior vice-president of media and general manager at Avenue A/Razorfish, the ad agency unit of digital marketing firm Quantive Inc. Perhaps as a result, Google seems to be trying to strike a more conciliatory tone of late. In its most recent earnings conference call with analysts, Schmidt and other executives mentioned the words "partner" or "partnership" more than 50 times. It may be working to some degree. Some TV networks, such as CBS, and other media outlets have found ways to work with Google. It has also sealed deals with Dell Inc. to install

Some think Google's data concentration raises concerns about national security

Google software on computers and even with sometime rival eBay Inc. to run ads on the online marketplace.

Ultimately, Google must grapple with the essential paradox it embodies. As a corporation, it's often a cipher, its intentions and methods concealed by algorithms that look impenetrable and impersonal. Yet the search engine and the blockbuster business built atop it utterly depend upon millions of people sharing through searches their most intimate desires, and upon thousands of businesses willing to open their data storehouses to feed Google's voracious digital maw. It may be that the data-driven culture that got Google this far needs to get a little more social in its dealings with the outside world. "It's not just about click-through on an ad," notes Steven E. Marder, CEO of Eurekster Inc., a search services provider that uses online communities to refine results. "It's about humans." ■

—With Ronald Grover in Los Angeles, Peter Burrows in San Mateo, Calif., and Tom Lowry in New York

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WHERE TO OGLE GOOGLE

ONLINE: *The Many Faces of Google* For a slide show looking at where Google could go from here, and an extended interview with Google CEO Eric Schmidt, please visit www.businessweek.com/extras.

PODCAST: *The Story Behind the Story* Executive Editor John A. Byrne interviews Silicon Valley Bureau Chief Robert D. Hof at www.businessweek.com/podcast.

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THE STORYTELLER
Schultz says it's all about an "authentic" coffee experience

Saving Starbucks' Soul

Chairman Howard Schultz is on a mission to take his company back to its roots. Oh, yeah—he also wants to triple sales in five years

"A heady aroma of coffee reached out and drew me in. I stepped inside and saw what looked like a temple for the worship of coffee.... It was my Mecca. I had arrived."

—Howard Schultz on his first visit to Starbucks in 1981

BY BURT HELM

ON APR. 3, STARBUCKS launches a pair of concoctions called Dulce de Leche Latte and Dulce de Leche Frappuccino. A 16-oz. Grande latte has a robust 440 calories (about the same as two packages of M&M's) and costs about

\$4.50 in New York City—or about three times as much as McDonald's most expensive premium coffee. Starbucks Corp. describes its latest concoctions, which took 18 months to perfect, this way: "Topped with whipped cream and a dusting of toffee sprinkles, Starbucks' version of this traditional delicacy is a luxurious tasty treat."

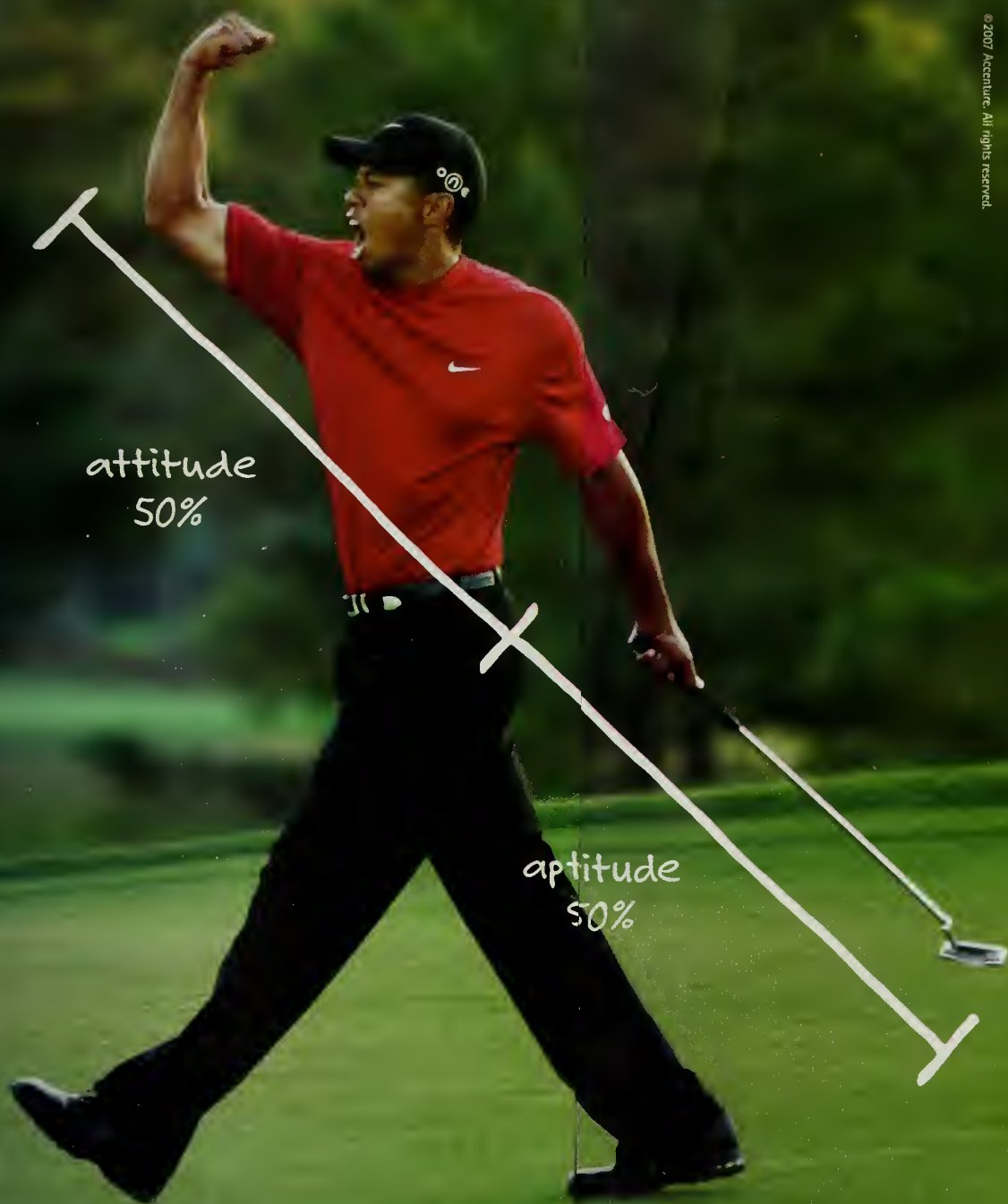
If you find yourself at Starbucks in the next few weeks, letting a Dulce de Leche Latte slide over your taste buds, you might wonder how this drink came to be. It's a tale worth hearing. On the surface it's a story

about how the Starbucks marketing machine conjures and sells café romance to millions of people around the world. On a deeper level it's a story about how a company, along with its messianic leader, is struggling to hold on to its soul.

Ask Schultz for the key to Starbucks and he'll tell you it's all about storytelling. Starbucks is centered on two oft-repeated tales: Schultz' trip to Seattle in 1981, where he first enjoyed gourmet coffee, and a 1983 trip to Milan, where he discovered espresso bar culture. Not only are these



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journeys useful touchstones for recruits, they also provide the original marketing story for a company that prides itself on giving customers an authentic experience. "The one common thread to the success of these stories and the company itself," says Schultz, "is that they have to be true—and they have to be authentic."

TRUE BELIEVERS

STORIES ALONE aren't enough, though, to fuel Starbucks' other obsession: to grow really, really big. By 2012, Schultz aims to nearly triple annual sales, to \$23.3 billion. The company also plans to have 40,000 stores worldwide, up from 13,500 today, not long after that. To hit its profit targets, Starbucks has become expert at something that's decidedly unromantic—streamlining operations. Over the past 10 years the company has redesigned the space behind the counter to boost barista efficiency. Automatic espresso machines speed the time it takes to serve up a shot. Coffee is vacuum-sealed, making it easier to ship over long distances. To boost sales, the company sells everything from breath mints to CDs to notebooks. Add it up and you have an experience that's nothing like the worn wooden counters of the first store in Pike Place Market or an Italian espresso bar.

Somewhere along the way that disconnect began to gnaw at Schultz. Most recently it manifested itself in a note he wrote to his senior team. The Valentine's Day memo, which leaked to the Web, cut to the heart of what he sees as the company's dilemma. "We have had to make a series of decisions," Schultz wrote, "that, in retrospect, have led to the watering down of the Starbucks experience, and what some might call the commoditization of our brand."

Now, Schultz is asking his lieutenants to redouble their efforts to return to their roots. "We're constantly—I don't want to say battling—but we don't want to be that big company that's corporate and slick," says Michelle Gass, senior vice-president and chief merchant for global products. "We don't. We still think about ourselves as a small entrepreneurial company." That's a tricky business when you have 150,000 employees in 39 countries. But keeping that coffee joie de vivre alive inside Starbucks is crucial to Schultz' entire philosophy. Who better to sell something than a true believer?

In 2004, Starbucks introduced something called the Coffee Master program for its employees. It's a kind of extra-credit course that teaches the staff how to

discern the subtleties of regional flavor. Graduates (there are now 25,000) earn a special black apron and an insignia on their business cards. The highlight is the "cupping ceremony," a tasting ritual traditionally used by coffee traders. After the grounds have steeped in boiling water, tasters "crest" the mixture, penetrating the crust on top with a spoon and inhaling the aroma. As employees slurp the brew, a Starbucks Coffee Educator encourages them to taste a Kenyan coffee's "citrusy" notes or the "mushroomy" flavor of a Sumatran blend.

If the ritual reminds you of a wine tasting, that's intentional. Schultz has long wanted to emulate the wine business. Winemakers, after all, command a premium by focusing on provenance: the region of origin, the vineyard, and, of course, the grape that gives the wine its particular notes—a story, in other words.

**18 MONTHS
IN THE MAKING**
The Dulce
de Leche
Frappuccino



Bringing wine's cachet to coffee will help take the brand upmarket and a Starbucks to sell premium beans.

The product and marketing people the strategy "Geography is a Flavor." in 2005 they began selling this new s with whole-bean coffee. The company organized the menu behind the counter grouping coffees by geography instead of by "smooth" or "bold." It replaced colorful Starbucks coffee bags with white packages emblazoned with color bands representing the region of origin. Later, for those connoisseurs willing to pay \$28 a pound, Starbucks introduced single-origin beans called "Black A Exclusives."

The next step was to reach the masses who buy drinks in the stores. The company decided to launch a series of in-store promotions, each with a new set of drinks that would communicate regional syncretisms to customers. The first promotion, the team decided, would highlight Central and South America, where Starbucks buys more than 70% of its beans.

The sort of authenticity Schultz wants to talk about is hard to pull off when you're the size of Starbucks. Telling a story to a mass audience sometimes requires smoothing over inconvenient cultural nuances. Plus, the marketing department has to work quickly to stay abreast of beverage trends, not to mention a host of such rivals as Dunkin' Donuts and McDonald's. Diving deep is not an option.

A year ago, 10 Starbucks marketing and designers got on a plane and went looking for inspiration in Costa Rica. "It's being able to say: 'This is how we made this [drink] is made,'" says L. McKenzie, who runs new product development. "Not because someone told us to read it somewhere." The Starbucks team spent five days in Costa Rica, traveling in a minivan owned by TAM Tours. Later, a smaller group toured Mexico City and Oaxaca as well.

MADE IN CHINA

THE MISSION WAS to find products that would evoke an authentic vibe in the U.S. That's harder than it sounds. Philip Clark, a merchandising executive, wanted to sell traditional Costa Rican mugs. But the ones typically used for drink coffee were drab and brown; they wouldn't pop on store shelves. Plus, they broke easily. Then he found Cecil Figueres, who handpaints ceramic in a mountainside studio an hour from the capital, San Jose. The artist favors bright floral patterns; they would look nicely. Starbucks paid de Figueres



TASTE TEST
Staffers rate
drinks-in-
progress

for her designs. Each mug will have a picture bearing her name and likeness; on the bottom it will say "Made in China."

Starbucks will weave artisans and other Costa Ricans into the in-store promotional campaign. Painter Eloy Zúñiga Guevara will appear on a poster with a decidedly homespun Latin aesthetic. (And if customers want some authenticity to take home with them, they can buy one of five paintings of Costa Rican farmers that Guevara produced for Starbucks. They will sell for \$25 apiece.) A second poster will feature Costa Rican coffee farmers from whom Starbucks buys beans. A third will show a grandmotherly figure cooking up dulce de leche on a gas stove. (She's a paid model at a Seattle.) Each poster will feature the tagline "I Starbucks."

Having devised a story, Starbucks brewed a drink that would say "Latin America." Beverage brainstorming takes place in the Liquid Lab, an airy space decorated in Starbucks' familiar blue, green, and orange hues. The room features huge bulletin boards plastered with the latest beverage trends. In this case it doesn't take an anthropologist to figure

out which drink Starbucks should use to promote its Latin American theme.

Dulce de leche is a caramel-and-milk dessert enjoyed throughout much of the region. What's more, Häagen-Dazs introduced dulce de leche ice cream in 1998, and Starbucks followed suit with its own ice cream in 1999. So Americans are familiar with the flavor, says McKenzie, but "it still has a nice exotic edge to it." Besides, she adds, caramel and milk go great with coffee.

Even so, concocting a drink is never simple at Starbucks. The research-and-development department routinely tackles 70 beverage projects a year, with 8 of them leading to new drinks. A drink must not only appeal to a broad swath of coffee drinkers but also be easy for a barista to make quickly so as to maximize sales per store (hello, Wall Street). "The store...is a little manufacturing plant," says Gass, and yet it must seem as though the drink is being handcrafted specially for the customer (hello, Howard Schultz).

Creating the Dulce de Leche Latte and Frappuccino fell to Debbie Ismon, a 26-year-old beverage developer who holds a degree in food science and has

worked at Starbucks for 2½ years. In late June, 2006, the design team brought her a small sample they'd whipped up that they felt embodied the right tastes, plus a written description of the characteristics they hoped to see. For the next four months, Ismon fiddled with various ratios of caramel, cooked milk, and sweetness "notes." After the design group decided which version tasted most "in-concept," Ismon mixed up three different flavors for the big taste test. One hundred or so random Starbucks employees filed in, sampled the drinks, and rated them on computer screens. The process was repeated two more times for each drink. Finally, 18 months after starting the process, Starbucks had its two latest premium beverages.

If previous drinks, such as Caramel Macchiato, are any guide, Starbucks' Dulce de Leche drinks will sell briskly. That should please Wall Street and perhaps even help perk up the stock, which is down 20% from its May, 2006, high on worries that operating margins are falling and that Starbucks could miss its ambitious growth targets.

And as you wait in line for your Dulce de Leche Latte, you might ask yourself: Are you paying \$4.50 for a caffeine jolt and caramel topping? Or have you simply been dazzled by Howard Schultz' storytelling magic? ■

The search for a Latin vibe led to Costa Rica —and the perfect mug

»THE GREENING OF AMERICA'S CAMPUSES

College students across the country are fired up about global warming, and they're gathering online to agitate for change. Is this the next big youth movement?

BY HEATHER GREEN

IT WAS A CRISP SEPTEMBER night in northern Vermont, and the narrow meeting room on the ground floor of a Middlebury College dorm was packed with students. They had gathered to hear Bill McKibben, resident scholar, author, and environmentalist, sketch out the future of climate activism. Persuading the U.S. government to get serious about global warming would take more than old-style protest marches and rallies, he explained. It would require a new kind of coordinated action, making smart use of the Net.

Seven months later, McKibben and a team of newly minted Middlebury graduates are trying to put this idea into practice. On Apr. 14, they're spearheading a nationwide virtual march on Washington called Step It Up. The campaign will seek legislation to cut carbon emissions by 80% by 2050, far beyond the goals in global agreements such as the Kyoto Accord.

Forcing any such laws through in 2007 is obviously a stretch. But Step It Up's tech-savvy tactics could produce some arresting results. About 1,100 campuses, church groups, and green organizations have already signed up

on the campaign's Web site to hold local, climate-related events. One group will ski in formation down the shrinking glaciers of Jackson Hole, Wyo. Another plans a diving expedition in Key West, Fla., to document the threat climate change poses to coral reefs. And at every step, McKibben's "distributed revolution" will not only be televised but will also be YouTube'd, blogged, and podcast.

If Step It Up succeeds in drawing together climate activists on campuses across the U.S., it could help catalyze the first mass student movement since the days of the Vietnam War.

The activities planned for Apr. 14 could coalesce into "the biggest grassroots environmental event ever," says McKibben. But will it really be more than a green-tinged digital lovefest? Youthful idealism, after all, is as old as it is ephemeral.

Over the years, generations of young folks have fallen passionately for issues, only to shove them into the closet with their demonstration banners as they get distracted by mortgages, day-care arrangements, and car repair bills. The "no-nukes" movement of the

1970s failed to rid the world of atomic weapons. And Asian sweatshops and child labor survived the outrage of campus activists in the 1980s.

It is also true, however, that some uprisings fueled by youthful passion—the civil rights movement and the anti-war demonstrations of the 1960s—have altered the course of U.S. history. Many social scientists, politicians, and business leaders say student-led climate activism could be a third. "It's a significant movement, and the start of bigger things," says Michael Oppenheimer, a prominent Princeton University geoscientist.

Unlike the Earth Day kids of the 1970s, climate activists who belong to the 80 million-strong demographic bulge known as the Millennials aren't hard left or anti-business. Sometimes called Gen Y (teens to mid-20s), they wield a tool kit that includes Excel spreadsheets, administrators' numbers



CHANGE AGENTS Middlebury College Scholar-in-Residence Bill McKibben (in chair) with his team of recent Middlebury grads. Back row, from left: Jamie Henn, May Boeve, Jon Warnow, Will Bates. Seated, from left: Jeremy Osborn, Phil Aroneanu



UNLIKE THE EARTH DAY KIDS OF THE 1970s,
TODAY'S **YOUNG CLIMATE ACTIVISTS** ARE
NEITHER HARD LEFT NOR ANTI-BUSINESS



on cell-phone speed dials, and blogs. And their ranks represent a wide swath of disciplines and beliefs, from the 3,000-member Engineers for a Sustainable World to the Evangelical Youth Climate Initiative to Net Impact, a green business school network with 130 chapters. Student groups at 570 schools signed up to take part this year in the Campus Climate Challenge, a campaign sponsored by 30 environmental groups.

For now, most Millennial activists are trying to hit the levers where they live, pushing their colleges to purchase renewable energy and construct green buildings. Students in the University of California system wrote the rule book, three years ago, when they persuaded administrators to buy green energy and embed commitments to green construction in a multiyear, \$7.7 billion budget for new buildings.

"BE CYNICAL...OR EFFECTIVE"

AT MOST COLLEGES, students set more modest goals. At Middlebury in January, 2005, two dozen students founded an activist group that now attracts about 100 students to its weekly meetings. Pressed by this group, Middlebury agreed to reduce emissions by constructing an \$11 million biomass plant to heat and cool buildings. The group also made presentations to trustees, including Felix Rohatyn and Lehman Brothers Inc. Chairman and Chief Executive Officer Richard S. Fuld Jr. "I am a big believer in the audacity of hope," says May Boeve, who helped found the group.



"You can be cynical, or you can choose to be effective."

J.P. Plumlee and his fellow activists at the University of Tennessee shared similar experiences. They floated a plan to adopt an \$8 annual student fee to help pay for purchases of alternative energy, and got the proposal endorsed by 4,100 students at the Nashville school—one of the highest turnouts for any such vote on campus. The students voted to impose levies on themselves that would be transferred to the university to help reduce its dependence on fossil fuels. Two other schools in the area have enacted similar programs, accounting for 24% of the Tennessee Valley Authority's clean-energy sales. Now, four more are following suit. "I used to think global warming was my grandchildren's problem," says the college's chancellor, Loren Crabtree. "But we need to deal with it now, and these young people are our leaders."

Sometimes, the force of students' convictions fundamentally alters institutions. Last year, Stanford University's Graduate School of Business redesigned its curriculum to emphasize issues linked to the environment and corporate responsibility. "Students are coming to school with a much increased awareness of their impact on society," says Garth Saloner, a Stanford economics professor who handled the revamp.

Now the first wave of Millennials is entering the workplace, and businesses that want to attract the most qualified candidates say they must appeal to students' environmental sensibilities. "They're the future leaders of our company, the fu-

ture investors, and future consumers says Lorraine Bolsinger, vice-president of GE's Ecomagination strategy. "Gen Y folks think that the environment is twice as important as the economy. We absolutely have to think about their concerns."

Over the next 10 years, there will be a major exodus from the work world as baby boomers retire. By 2012 there will be just one person entering the workforce for every four who leave, according to Labor Dept. data. So companies ranging from Whirlpool and Ben & Jerry's to Google

ENERGY

Tennessee
Chancellor
Crabtree,
Plumlee

Hewlett-Packard, and General Electric say they must understand what motivates climate activists.

Corporate recruiters are encountering more and more candidates like Anna da Baron. When she applied for a job with Pacific Gas & Electric Co. last year, the 21-year-old student at Northwestern University's Kellogg School of Management dove deep into the utility's environmental briefs. Baron says she was impressed by PG&E's clean-energy strategy. But before accepting an invitation to attend a first round of interviews, she set up a 45-minute call with the company's environmental affairs director in Washington. "Business is going to play a role in these issues, and I would like to be there to help out," said Baron, who wound up accepting the job PG&E offered.

What students want is of great interest to companies that serve student communities. Sodexo Alliance, which handles food and cleaning contracts for 900 colleges and independent schools, is seeing a 20% annual increase in the number of accounts demanding food that is local, organic, and grown sustainably. Burning gasoline or jet fuel to haul produce the sands of miles from where it's grown is especially galling to students, so Sodexo is finding and partnering with local suppliers and manufacturers.

If Bill McKibben's Step It Up campaign and other such efforts succeed, rallying students behind a single environmental banner, an unexpected force could be unleashed. College kids rarely flock to the polls, but in the past 16 federal elections their numbers have grown. "This is a powerful political generation," says William Strauss, a brand consultant and co-author of *Millennials Rising*. The youth vote helped swing the 2006 midterm elections in favor of green-leaning Democrats, with the addition of an estimated 2 million new, young voters at the polls. In 2008, global warming "has the power to bring voters out

their dorm rooms," says Steve McMahon, Democratic consultant.

It's fair to be skeptical about a green alliance of politicians, captains of industry, and campus activists. For every company that commits to going green, a dozen others are trying to "greenwash" their reputations. Students, meanwhile, still against the ungreen acts of government and industry, but can't be pried from their iPods, made by Apple Inc., a company that has yet to embrace sustainable manufacturing.

Gwynne Rogers, an analyst at the National Marketing Institute in Harleysville, Pa., also questions whether students can deserve their enthusiasm. "For a fleeting moment, you care passionately about a given issue. Then you are exposed to another, and your allegiance changes." But because the students are part of a broad-societal shift and will bear the brunt of any climate catastrophe, Middlebury's McKibben thinks climate activism could be one of those movements that makes a difference. "There are a lot of people who are educated about global warming and want to figure out what to do," he says. The students, ultimately, are the main-team-in-training. ■

Pupil Power

Student movements over the decades have a mixed track record in reshaping social and business practices



1955-1968

Civil Rights

Students help propel this movement with voter registration drives, participation in large-scale demonstrations, and boycotts that put pressure on local businesses.

1965-1970

Vietnam War

War galvanizes the biggest youth uprising of the 20th century. Teach-ins on campuses target corporations, including GE and Dow Chemical, for their role in the war effort.

1977-1989

Apartheid

Two separate waves of student protests force about 150 colleges to divest billions in endowment funds from companies doing business in South Africa.

1995-PRESENT

Sweatshops

Students focus on college labor conditions and Asian sweatshops, demanding fair wages and improved work conditions at colleges and companies. But sweatshops are still with us today.

1995-PRESENT

Globalization

Protesters decry the power of multinationals, accusing them of operating against the interests of Third World nations. But protests have not slowed the trend.

2004-PRESENT

Darfur Genocide

Mimicking the tactics of the anti-apartheid activists, students pressure schools to pull endowment fund investments out of companies doing business in Sudan. Results are unclear.

We call it **FIRST COFFEE**

GIVEN THE RIGORS OF THE PROGRAM

it usually isn't the

LAST



By 9:30 a.m. MBA students at the University of Virginia are well into their day. Perfect time then for First Coffee, a tradition dating back to the founding of the Darden School of Business. At First Coffee, students and faculty gather to discuss entrepreneurial ideas, strategies for interviewing or even to swap running routes.

But there is also a very practical side to First Coffee – THE COFFEE. With classes through early afternoon, individual case preparation, club meetings, recruiting briefings, presentations, and late night sessions with learning teams, let's just say that here at Darden, a little boost occasionally comes in handy. www.darden.virginia.edu

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Secrets of An HR Superstar

On the eve of retiring, GE's Bill Conaty offers tips on nurturing leaders in your organization

BY DIANE BRADY

GENERAL ELECTRIC CO.'S legendary reputation in talent management owes much to one man: William J. Conaty. In his 40 years at GE, including 13 as head of human resources, he helped to shape the modern face of HR. "The guy is spectacular," says former Chief Executive and *Businessweek* columnist Jack Welch. "He has enormous trust at every level. The union guys respect him as much as the senior managers."

Conaty took a department that's often treated as a support function and turned it into a high-level business partner, fostering a deep bench of talent and focusing attention on the need for continuous leadership development. Among other things, he helped manage the seamless transition from Welch to Jeffrey R. Immelt in 2001 and was critical in shaping a new vision of global leadership that emphasizes such traits as imagination and inclusiveness. At 61, Conaty is now easing into retirement, having passed the top job over to longtime HR colleague John Lynch earlier this year while agreeing to stay on to handle GE's labor union negotiations this summer. As he winds up affairs at GE, Conaty shared his advice for nurturing leaders.

DARE TO DIFFERENTIATE Relentlessly assessing and grading employees build organizational vitality and foster a true meritocracy, in Conaty's view. Employees must be constantly judged, ranked, and

rewarded or punished for their performance. Welch famously talked about cutting the bottom 10% of employees. Immelt doesn't like to fixate on hard targets. But Conaty insists that differentiation "is what still drives this company." There's nothing like a bit of anxiety and the knowledge that you're being measured against peers to boost performance. "We want to create angst in the system," he says. "We have evolved from being anal about what percent have to fall into each category. But you have to know who are the least effective people on your team—and then you have to do something about them."

CONSTANTLY RAISE THE BAR Leaders continually seek to improve performance, both their own and their team members'. "The one reason executives fail at GE is they stop learning," says Conaty. "The job grows, the accountability grows, and the people don't grow with it." Continuous learning is so valued that GE training courses are considered high-profile rewards. Getting tapped to go to Crotonville, the 53-acre executive training center in New York's Hudson River Valley, is a signal that someone is poised to

go to the next level. "Crotonville is one of the best tools we have in our arsenal," says Conaty. The company's extensive training programs are a powerful recruitment tool and help to stimulate midcareer employees. Moreover, GE uses Crotonville and other training centers worldwide as a way to recognize valued customers and business partners.



'FIRST FRIEND' Conaty (left) is valued by GE CEO Immelt (right) for his candor

DON'T BE FRIENDS WITH THE BOSS

Too often, says Conaty, HR executives make the mistake of focusing on the priorities and needs of the CEO. That diminishes the powerful role of being an employee advocate. "If you just get closer to the CEO, you're dead," says Conaty. "The HR leader locks in with the CEO, and the rest of the organization thinks the HR leader isn't trustworthy and can't be a confidant."

Conaty tries to counteract that risk by distancing himself from Immelt in public settings. While few people spend more time with Immelt than Conaty, he deliberately socializes with other colleagues at functions. Moreover, Conaty says he is the one to "purposely throw the daggers at Jeff that the other guys don't dare do. He knows what I'm doing. I need to be independent. I need to be credible." He also makes a point of being candid with leaders in private. As Immelt recently remarked: "I call Bill the 'first friend'...the guy that could walk in my office and kick my butt when it needed to be."

BECOME EASY TO REPLACE

Great leaders develop great succession plans. Insecure leaders are intimidated by them. "I can go business by business and tell you where we're strongest and weakest on succession. It all comes down to having an executive who doesn't want to admit someone else could do the job," says Conaty. "If they kill two three viable successors along the way, you have to start looking at the person who's doing the killing." At GE, leaders are judged on the strength of their team and are rewarded for mentoring people throughout the organization. Conaty, one, takes pride in the fact that his successor is someone that he helped develop within the HR function at GE.

BE INCLUSIVE Within every organization, there's a tendency to favor people you know. That can undermine success. Conaty winces at the memory of GE's acquisition of Borg-Warner's chemical business in 1988. "We figured that the sales force didn't look quite as spiffy as energized as our GE team," he says. T



CONATY ON RANKING EMPLOYEES

We want to create angst in the system. ...[Y]ou have to know who are the least effective people on your team."

ON MANAGING UP

If you just get closer to the CEO, you're dead. ...[T]he rest of the organization thinks the HR leader isn't trustworthy and can't be a confidant."

ON SUCCESSION

If they kill two or three viable successors along the way, you have to start looking at the person who's doing the killing."

management jobs went to GE folks, marginalizing the existing team. "We ended up losing most of their sales force, and lost the business with it."

Now, GE rigorously assesses the talent within companies before they're even acquired. It's a critical form of due diligence. "We find there are generally half a dozen people that we've got to have on the team at that company, and we need them there for a few years," he says. "Now we make special provisions to make them feel financially welcome—as well as emotionally welcome. Our GE people can't be the winners in these deals."

KEEP UP OTHERS TO DO THEIR JOBS When it comes to the CEO, says Conaty, "one of the jobs is to take things off his desk, not put things on his desk." Ram Charan, a

management consultant who has worked with GE executives, says Conaty "has the intensity to look at the nuances of issues and take these things off the CEO plate. He solves things and goes forward."

That attitude extends to giving people the tools and permission to work on their own terms, and even GE has become much better about letting people step off the track for a while. "That used to be the kiss of death," says Conaty. He points to someone like Sharon R. Daley, a senior HR executive who turned down a promotion to spend more time with her kids. GE kept her in a part-time job until she was ready to take on new challenges. Today she's a company officer and the top HR person in the energy business. Conaty does draw limits. "I'm still cynical about seeing 'WFH' [working from home] on

a calendar, especially on a Friday," he notes. "But we're much more open and flexible because you see the payoff."

KEEP IT SIMPLE Most organizations require simple, focused, and disciplined communications. "You can't move 325,000 people with mixed messaging and thousands of initiatives," notes Conaty. Leaders succeed by being consistent and straightforward about a handful of core messages. And the best don't get derailed when times turn tough. "I'd say 70% of our leaders handle adversity well, and 30% let it overwhelm them," says Conaty. "If you can't take a punch and you don't have a sense of humor, you don't belong in this company. Everyone experiences failure now and then. It's how you handle it that matters." ■



EADS' Unlikely American Ascent

Despite setbacks for Airbus, the European aerospace giant is scoring U.S. defense deals

BY STANLEY HOLMES

IN RECENT MONTHS NOTHING but bad news has emanated from European Aeronautic Defence & Space Co. The epic production delays plaguing the vaunted Airbus A380 superjumbo jet have saddled the company with a \$3.3 billion cost overrun. They've also triggered the departure of several top officers, including two CEOs.

But there's one surprising bright spot for EADS—in the U.S., of all places, where the European aerospace giant has never been particularly well liked. Defying the skeptics, its U.S. defense arm, EADS North America Inc., is thriving. The unit's sales have steadily ballooned to more than \$1 billion—up from just \$400 million in 2004. And now, under the leadership of CEO Ralph D. Crosby Jr., 59, a former senior Northrop Grumman Corp. executive, the European-American company is actually contending (with partner Northrop) for one of the richest Pentagon prizes in decades: the \$100 billion contract to replace aerial refueling tankers. “Every-

body thought the penetration of the North American market by anyone other than the British was near impossible—certainly not by a company with a heavy French accent,” says Joseph F. Campbell Jr., aerospace analyst for Lehman Brothers Inc.

Crosby's strategy has been simple: “Crawl, walk, run,” as he puts it. He has been careful to bid only on U.S. defense contracts where EADS clearly brought something unique to the table. A good example is the light-utility helicopters built by Eurocopter. It offered a noncombat chopper that cost less and could be delivered more quickly than the ones offered by U.S. competitors, the U.S. Army concluded. What's more, EADS boasted clearly superior copter technology. The U.S. Army purchased 322 helicopters last year, the single

CROSBY He sold the U.S. Army 322 helicopters last year biggest Eurocop order. “We were quite prudent about the expectations we had established and the claims we made,” Crosby said.

His experience in the domestic defense industry has given him discerning political antennae. One of Crosby's first moves was establishing stateside final production factories, which brought 645 high-paying assembly jobs, in Texas, Mississippi, and Alabama. Another 200 people are expected to be hired in Mississippi as the helicopter factory there shifts into high gear. That has helped win the support of high-powered senators such as Richard C. Shelby (R-Ala.) and Jeff Sessions (R-Ala.), who sit on influential Appropriations and Armed Services committees, respectively. Another key friend in Washington is Senate Commerce Committee member Trent Lott (R-Miss.).

Crosby has also been savvy about partnering with big U.S. contractors. EADS North America, for example, is joining with Raytheon Co. and engine maker Pratt & Whitney in the bid to win the U.S. Army Joint Cargo Aircraft contract. The initial competition is for 33 small, off-the-shelf cargo aircraft worth \$1.3 billion. But it could ultimately run as high as \$6 billion for 145 planes.

For Crosby and his staff of U.S. defense executives, the acid test is tankers. The initial contract is for 180 planes worth about \$30 billion, and the Pentagon will announce the winner in October. But bidding for the lucrative tanker will put European company in the glaring political spotlight for a contract that doubters will never go to a company backed by French government. Beyond tankers, the real staying power of EADS North America will be tested during the decline in defense spending, which is expected to start in two years. “What happens when the big

gets start going down the small guys and foreigners get squeezed out,” says Loren Thompson, a defense analyst for Lexington Institute, a Washington area think tank. “The system only welcomes foreigners when budgets are flush.”

Crosby brushes off the criticism. “This is the largest defense acquisition for the next 20 years,” he says. “We came here to win.”

TAKING OFF

Revenues have been soaring at EADS North America



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Fleeing Biotechs? Not So Fast

Investors are nervous about generic drugs coming to biotech. They shouldn't be

BY JOHN CAREY

THE STOCKS OF BIOTECH companies took a hit in late February, when members of Congress introduced bills that would allow copycat versions of their blockbuster drugs.

Until now, competition from generic drugs has been limited to traditional medicines, like Prozac, made from small chemicals. That has trimmed billions of dollars from pharmaceutical industry profits, while biotech companies have been able to charge staggering monopoly prices for their more complicated medicines. A year's worth of Genzyme Corp.'s Cerezyme for Gaucher's disease tops \$200,000. Genentech Inc.'s Avastin, first approved for colon cancer, can cost \$100,000 per year. If Congress were

to break the logjam that restricts generic biotech drugs, it stands to reason the nation's health-care system would save billions each year. And the impact on the industry? "Devastating," says Genzyme CEO Henri A. Termeer. No wonder investors are skittish.

But bailing out of biotech may be the wrong response. The actual threat is both small and far away. Therefore, any dip in stock prices caused by worries over bio-generic competition "is a buying opportunity," says A.G. Edwards Inc. biotech analyst Aaron S. Reames. Plus, surprisingly, some biotech and big pharmaceutical companies may be among the beneficiaries when Congress does open the door to biotech rivals.

The first point to consider is that generic biologics are still years away. While the new legislation has backing

from Representative Henry A. Waxman (D-Calif.), and Senators Hillary Clinton (D-N.Y.) and Charles E. Schumer (D-N.Y.), and is seen as inevitable in the long run, Washington pundits put the chance of its passing this year as no better than 50-50. The bill will need the support of Senator Edward M. Kennedy (D-Mass.), chairman of the Health, Education, Labor & Pensions Committee, who is being lobbied heavily by Massachusetts biotech companies that oppose it. And Kennedy has his hands full renewing a law that pays for drug reviews by the Food & Drug Administration with industry fees. That law is set to expire this year.

Then, once a bill passes, it will take the FDA at least three years to issue the necessary regulations, and two more years to approve the first bio-copy. "Bio-generics' time has come, but it will be five or six years before they have an effect on the marketplace," says Citigroup health policy analyst Paul Heldman.

LIMITED ENTRY

IN ADDITION, BIOTECH medicines like anemia-fighting erythropoietin (EPO), an \$11 billion per year blockbuster for Amgen Inc. and Johnson & Johnson, are large molecules that are difficult to make. Small changes can cause serious side effects. So the FDA will require clinical trials of most copycat versions, essentially limiting entry to competitors with special expertise and deep pockets. Doctors w

so be wary of switching to unproven copies, so these competitors will have to spend marketing dollars. And it's unlikely that patients will be automatically switched to generic biologics, the way they are with today's generic drugs. The result will be a limited supply of relatively high prices. Today's generic drugs grab 80% or more market share within weeks of a brand-name drug losing patent protection, and eventually cost a third or less of the brand product's price. That won't happen with biotech copies. Anyone who expects to see prices drop with small-molecule generic drugs is dreaming," says Ira S. Loss, vice-president of Washington Analysis Corp. "Biological

generics are coming, but they aren't coming tomorrow, and they won't be a catastrophe for the biotech industry."

To put the threat in perspective, the sales of biotech drugs in the U.S. are now about \$30 billion a year and could jump to \$90 billion by 2010. The eventual hit from copycats, in contrast, will be a few billion dollars per year, analysts estimate. That's hardly the menace one would imagine based on the biotech industry's dire warnings and intense lobbying against the bill. "Don't get out the violin when you hear them moaning," says Consumers Union policy analyst William Vaughan.

Still, a market of a few billion dollars is worth pursuing. The twist is that the

big players probably won't be today's top generic companies like Mylan Laboratories, Barr Pharmaceuticals, or India's Ranbaxy Laboratories. Instead, "it may be Big-Cap Pharma or other biotech companies that decide it is an opportunity and that turn on their own," predicts Cowen & Co. analyst Ken Cacciatore. Two to watch are the Sandoz unit of giant Novartis and Teva Pharmaceutical Industries, which now makes both generic and brand-name drugs. So investors have a chance to profit from any misguided biotech downturns due to action in Congress, and to make a long-term bet on the winners in the biologic copycat market—whenever it arrives. ■

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Don't Quit Your Day Job, Podcasters

Grammar Girl hit it big, but so far few others have been able to make the shows pay

BY HEATHER GREEN

LISTENING TO GRAMMAR Girl's *Quick and Dirty Tips for Better Writing*, one of the Web's most popular independent podcasts, isn't the chore you might imagine. For 5 to 8 minutes each week, host Mignon Fogarty soothingly guides listeners around the pitfalls of common grammatical usage. Worried about when to use the word bad vs. badly? No problem. Yet even as you're taking in advice about whether split infinitives are acceptable (they are, she contends), it's hard not to wonder why you voluntarily took a seat at your fifth grade desk again. Or, more important, why you

didn't think of doing this show yourself.

With *Grammar Girl*, Fogarty has skyrocketed to the top of the iTunes 100 list of the most popular podcasters, drawing around 150,000 weekly downloads. That has led to an appearance on *The Oprah Winfrey Show* and advertising and book deals that enabled Fogarty to pull in a little under \$100,000 in six months of podcast-

ing and quit her day job as a technical writer.

Because podcasting appeared around the time that blogging, social networking and RSS data delivery services were becoming more commercial, expectations immediately soared that this would be the next Web phenomenon to hit it big. "It took years for bloggers and even publishers who are embracing RSS to start asking, 'How are we going to make money off this?'" But it took podcasters about a day," says Rick Klau, vice-president at FeedBurner, which helps publishers distribute blogs and podcasts.

Most of them are still asking. Fogarty's success is more the exception than the rule among indie podcasters. While there has been an explosion of shows over the past couple of years, offering everything from advice on how to manage your money to Italian lessons, podcasting business prospects are just developing. The share of Americans who listen to audio downloads from the Web has grown only slightly in the past year, to 13% from 11%, according to a survey released last month by Edison Media Research. Those listeners increasingly are crowded around the most popular podcasts. But lack of standards for placing podcast ads or measuring audiences has hobbled spending, which only hit \$80 million last year.

Many of the top podcasters are turning to ad networks such as FeedBurner and Podtrac Inc., which have sales teams courting ad agencies. But results so far are mixed. Podtrac has worked with advertisers such as Dell, AT&T, and HBO to sell show audio spots across its network of 5,000 independent podcasts. For the most part, though, marketers are doing only short runs of one to three

LISTEN UP Fogarty's *Grammar Girl* podcast draws 150,000 downloads each week



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months, and there aren't nearly enough spots to fill available slots. "Significant budgets aren't shifting to podcasting," says Jeff Marshall, a senior vice-president at advertising agency Starcom IP. "We're selectively choosing when and where to use podcasting."

At the high end of the scale are video bloggers such as *Rocketboom*, which pulled in around \$250,000 last year. At the other end is *MuggleCast*, a show created by eight Harry Potter fans. *Mug-*

the show and their lives. As a result of this devotion, the audience last year was willing to snap up about \$80,000 worth of T-shirts, key chains, and other merchandise emblazoned with the *Keith and the Girl* logo, showing a stick figure boy and girl.

For other indie podcasters, working with companies to create internal corporate podcasts or signing up to front for more traditional media is a way to stay in the game until advertising picks up.



gleCast isn't hurting for audience: It attracts 50,000 weekly listeners and is consistently in the iTunes Top 100. Yet ad deals are sporadic, and the crew behind the show, all under age 25, don't work full-time on it. So *MuggleCast* brings in only around \$1,000 to \$1,200 each month, though that's still more than most indies. Indeed, fewer than 100 of the people running the 55,000 active podcasts have been able to quit their day jobs, estimates Rob Walch, a podcasting veteran who produces Presidential candidate John Edwards' podcast.

In the absence of consistent advertising support, indie podcasters have to be inventive. Keith Malley and Chemda Khalili, the couple behind *Keith and the Girl*, an engaging, sometimes raunchy Howard Stern-like podcast, have cultivated a devoted online audience. (Six fans have already had *Keith and the Girl* tattoos done.) The show, which has 35,000 daily listeners, is just one part of the brand. Just as important to fans are the online forums and MySpace.com pages where they gather to talk about

SKEPTICS McCarthy and Colanduno's *Skepticity* was an early podcast hit

ing to walk and read again, Colanduno's speech therapist used the podcast recordings to teach him to talk.

Colanduno began recording again and the pair was asked to do an official podcast for *Skeptic* magazine. They jumped at the chance. The publication ponies up a small fee per podcast, but the real payoff for Colanduno and McCarthy is the free plug they get for their own show.

Even the most successful podcasters have to rely on some luck. In late 2005, *Grammar Girl*'s Fogarty was working full-time writing technical documents for biotech companies and hospitals, and spending 10 to 20 hours a week working on another podcast, *Absolute Science*. For six months she and a

friend toiled away on the one-hour science news show, which was only moderately successful. Still, inspired by 10 shorter podcasts she was listening to and the endless flow of grammar facts she encountered in her day job, Fogarty decided to try something else. *Grammar Girl* debuted last July. She was quickly noticed by the gatekeepers at iTunes, which look for variety to feature on its home page.

'GETTING SERIOUS'

THAT CATAPULTED *Grammar Girl* into the Top 100 and gave Fogarty a heady dose of instant fame. She spent hours before and after work cultivating her niche community, publishing a word-for-word transcript of each show and answering e-mails personally. By integrating the show with the e-mail and MP3 questionnaires from listeners, Fogarty spurred word-of-mouth popularity. Sharing the issues other listeners were grappling with helped make the show more intimate, clinching *Grammar Girl*'s appeal.

The next couple of years will reveal whether the hard-working indie podcasters are pioneering a nascent industry or destined to occupy a dedicated niche. It helps that more people are buying digital media players such as iPods and smartphones capable of playing podcasts, as does the inclusion of podcasting technology in the new Windows Vista operating system and Apple's iTunes. The ad networks are working on developing more sophisticated metrics. As more polished podcasts are also helped to create a broader audience, says Tim Bourquin, founder of the popular Podcast & New Media Expo conference. "On the production side, we're a lot more mature," says Bourquin, who points to the lessons people have learned about sound quality and focusing more sharply on subjects. "There are lots of people who are getting serious about the quality of podcasts."

Still, it's becoming clear that podcasting won't be the one new innovation that will gather together rapidly fragmenting audiences. Instead, it's just one of many technologies contributing to the dispersal of the crowd. That will continue to make it difficult for many podcasters to cash in. But it should give anyone with a passion to create a podcast hope of finding at least a small audience.

THE STAT

\$80 million

Total advertising spending on podcasts last year

Data: eMarketer Inc.



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Factories Go South. So Does Pay

Mexico's auto industry is booming, but parts outsourcing is keeping a lid on wages

BY GERRI SMITH

THESE SHOULD BE THE best of times for Mexico's auto industry. The country produced a record 2 million cars and light trucks last year, exporting three-fourths of them, while more than \$4 billion in foreign investment poured into the sector. And the government anticipates much more as Detroit's cash-strapped automakers head south for cost savings.

But Mexico's auto workers are worried. The reason: outsourcing. Sure, U.S. carmakers are shuttering plants up north, which will likely lead to new factories in Mexico. General Motors Corp., for example, is building a \$600 million plant in San Luis Potosí that will employ 2,000 starting in 2008. The Mexicans, though, fear new investments may not mean oodles of relatively high-paying jobs. That's because even south of the border automakers face relentless pressure to cut costs.

So they're saving on inventory and labor by shifting work to suppliers, which deliver pre-assembled pieces of cars

directly to the factory floor. More than 13,500 parts jobs were created in Mexico last year, vs. 4,500 coveted assembly positions, which have been a ticket to the middle class for many Mexicans. "Ford and other automakers are increasingly relying on outsourcing," says Juan José Sosa, national secretary-general of the Ford Autoworkers Union in Mexico. And like their Detroit counterparts, Mexican auto workers are feeling the squeeze of global competition. "The companies are always saying...that in China costs are much lower or that unions in the U.S. are offering very good concessions,"

THE STAT

48,650

Auto assembly workers in Mexico in 2006, down 6.7% since 2002. By contrast, the auto parts workforce is up 9.3% to 456,500.

Data: National Autoparts Industry Assn. (Mexico) estimates
National Institute of Statistics, Geography & Informatics (Mexico)

DELPHI PLANT
Some workers
get just \$1.50
an hour

says Sosa. Ford acknowledges that outsourcing more, part of an effort to become more competitive worldwide.

tive worldwide.

That's not to say Detroit isn't already saving a bundle by moving to Mexico. Mexican assembly workers average just \$3.50 an hour plus benefits, compared with about \$27 hourly plus benefits at a GM or Ford plant in the U.S. But less skilled workers at parts makers such as Delphi Corp. in Mexico earn as little as \$1.50 per hour, and their benefits are skimpier because unions are weaker in the fragmented parts industry.

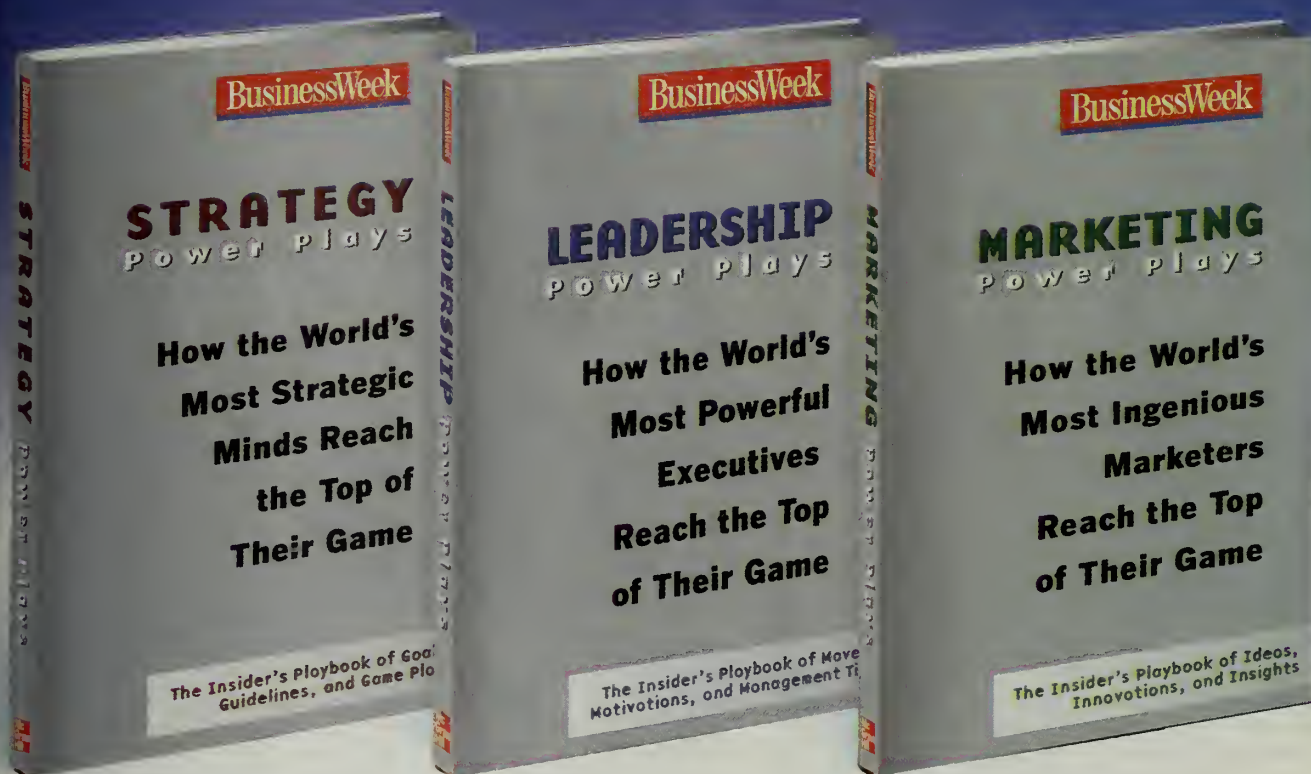
FORD IN THEIR FUTURE?

KARLA FABIOLA VALDÉS knows just how big the difference is. In October, 2005, she started working in Ford Motor Co.'s Hermosillo plant in northwestern Mexico and for almost three years earned \$3 an hour assembling Ford Focus compact cars. Then Ford laid her off after U.S. demand for autos slumped. In December, Valdés started working in the plant again—but delivering components as an employee of a logistics outsourcing company. Now she earns just \$1.50 per hour. "I was so happy working for Ford," says the 36-year-old mother of three teens. "I hear they may be hiring again. I'm still holding out hope."

Thousands of other Mexican workers are waiting to see if much-rumored investments by U.S. carmakers materialize. After Ford announced it was shutting 14 North American factories, word spread that it would open new facilities in Mexico. The company denied the reports, but the Mexican government predicts the auto industry will attract \$1 billion in investment over the next five years. The lure: Mexico's proximity to the U.S., its low wages, and its free-trade agreements with the U.S., Europe, and Japan, which make exporting easier.

Yet as investment picks up, even assembly jobs in Mexico are becoming less lucrative. Two years ago Ford embarked on a \$1 billion expansion in Hermosillo, which employed 1,200. The company came down with union leaders and pledged to create as many as 2,000 more jobs, long as workers agreed to flexible work rules and lower starting wages. Today the union says, about half of the factory's 3,000 hourly workers earn \$2 an hour, just half what those with more seniority do. "It's a reality we cannot deny," says César Flores, president of the Mexican Automotive Industry Assn. "An assembly plant now creates fewer good jobs."

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Vultures To the Rescue

A new market gives holders of distressed hedge funds a quick escape

BY MATTHEW GOLDSTEIN

TWO YEARS AGO, BAYOU Group, a hedge fund based in Stamford, Conn., collapsed amid charges of phony bookkeeping by its founder, Samuel Israel III. Since then, investors in the once-\$300 million fund have been biding their time, waiting for the bankruptcy court to divvy up what's left, potentially around \$100 million. But there's no guarantee they'll get any money back. So in mid-March, Argo Partners, a New York firm that specializes in buying distressed assets, offered to buy their stakes for 10¢ on the dollar—giving Bayou investors an easy escape from the litigation logjam.

Argo isn't alone in trolling among the hedge fund wreckage. Liquidity Solutions Inc., a Hackensack (N.J.) company, last summer made a similar offer to Bayou investors but was rebuffed. Distressed-debt traders at Deutsche Bank have reached out to limited partners in now-defunct funds like Bayou, Wood River Capital Management, Lancer Management Group, and Beacon Hill Asset Management.

So far, Bayou investors aren't selling out, calling Argo's initial offer "too cheap." But such flameouts have proven to be tempting fare for vultures. Hedgebay Trading Corp., an online exchange that matches up buyers and sellers in a secondary market for hedge funds, estimates distressed stakes now account for 25% of its business, up from 8% four years ago. "We have gotten a lot of calls of late from both buyers and sellers [of troubled investments],"



says Barry E. Silbert, chief executive officer of Restricted Stock Partners, another middleman who's considering getting into the hedge fund game.

Like Bayou, many scandal-plagued funds are tied up in bankruptcy litigation with investors trying to recover what money they can from managers who allegedly bilked them. Scavengers are betting that once the courts have their say they will be able to collect a tidy sum. Consider Beacon Hill, a hedge fund that largely bought mortgage-backed securities. The former managers of the Summit (N.J.)-based fund paid \$4.4 million in penalties to settle

charges they manipulated the returns of its bond funds, and a court-appointed receiver is now dividing up Beacon's assets. A Morgan Stanley fund that invests in hedge funds estimates its original \$18.3 million investment will be worth \$8.3 million once the litigation plays out. Sure, that's a 53% loss for Morgan Stanley. But for scavengers like Argo that jump in after a fund's demise and buy at cut rates, such moves can reap a pretty sweet gain.

UP FROM UNDERGROUND

BEFORE, INVESTORS IN damaged funds had little choice but to hold on and wait out the bankruptcy proceedings. Now, says Scott Berman, an attorney with Friedman Kaplan Seiler & Adelman in New York who often represents investors caught in hedge fund meltdowns, that's changing. Vulture players are creating a necessary secondary market for investors who prefer to cash out their losses sooner rather than hope for a recovery down the road. The fledgling market began six years ago as a way for pensions, Wall Street banks, funds of funds, and other large institutional investors to buy shares in hot funds that had stopped accepting new money. There's a similar underground exchange for swapping shares in private equity funds, which has taken off largely because those buyout firms maintain

long lockup periods that prevent investors from pulling out their money for as long as two years.

Today, distressed stakes, either in underperforming funds or those that have imploded from scandal, are the fastest-growing segment of hedge fund trading. When Amaranth Advisors collapsed in September after losing \$6 billion on natural gas bets, a number of investors put their partnership interests up for sale on Hedgebay for as little as 35¢ on the dollar. Laurence Allen, CEO of NYPPEX, a firm best known for its online private equity trading platform, is optimistic about opportunities in the hedge funds, especially as funds adopt longer lockup periods. But he cautions investors against latching on to the first deal that comes their way. "Don't hit these bids that are pennies on the dollar," says Allen. "Sometimes the assets aren't as bad as they appear." ■

THE STAT

10¢

The amount on the dollar Argo Partners offered investors in the bankrupt fund Bayou Group

Data: Argo Partners

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At the Head of the Headhunting Pack

Heidrick & Struggles' sector will only continue to expand as baby boomers retire

BY ROGER O. CROCKETT

THESE ARE NERVE-WRACKING times for CEOs. Last year, more than 28,000 top executives lost, left, or changed jobs, up 68% from 2005, according to Liberum Research. But turnover makes at least one chief executive happy: L. Kevin Kelly of recruiter Heidrick & Struggles International Inc. "It's a buoyant market," he gushes. "There's a huge demand for talent."

Change in the C-suite has translated into big money for Heidrick. The Chicago company racked up revenues of \$479 million in 2006, a 16% jump over the previous year. All that flux has shareholders enthusiastic as well. Since Kelly took the helm in September, the stock has soared 37%, to 49, compared with a 9% gain for the Standard & Poor's 500-stock index and 12% for Korn Ferry, the other top-tier, publicly traded search firm. (*BusinessWeek's* parent, The McGraw-Hill Companies, employs Heidrick for some of its executive searches.)

Despite Heidrick's highs, some investors still figure there's considerable upside over the long term. For one, baby boomers will be retiring in droves over the next 10 years, with a shrinking pool of 35-to-50-year-olds to replace them. The Association

of Executive Search Consultants expects more than 50% of top managers to leave within five years. Since its stiffest competition for high-level searches, Spencer Stuart and Russell Reynolds Associates, are privately held, Heidrick is one of the few ways for investors to play this demographic shift. "They have a great reputation and a lot of trends driving growth," says William F. Fiedler, a portfolio manager at Skyline Asset Management, which owns more than 675,000 shares of Heidrick.

MARGIN CALLS

YET KELLY KNOWS he needs to continue spiffing up those businesses, especially the European operations. Europe generates about a third of Heidrick's sales; its 9.1% operating margins are much slimmer than those in the Americas (20.3%) and Asia Pacific (26.8%). Fiedler is attacking the problem, shuttering unused office space as well as cutting administrative staff and underperforming recruiters. Fiedler figures Heidrick

can improve margins in Europe by 15%, "which would be huge."

Of course, the big question is Heidrick in the short term in the economy. When the tech bubble burst, net revenues plummeted from a peak of \$594 million in 2000 to \$320 million by 2002.

With economists worried about a slowdown, Heidrick and others could suffer. "If you look back over history, it shows you don't want to project the good times will keep going," says analyst Kristian Rowland of Morningstar Inc.

But Heidrick is better prepared for the time. It has diversified, de-emphasized technology, and although 34% of its revenues now come from the financial sector, they are spread across different segments, such as asset and wealth management, insurance, and private equity. Overall, Kelly anticipates a revenue increase of roughly 20% from 2006, and record operating margins of 13%.

Heidrick also has a pristine balance sheet, with some \$221 million in cash and practically no debt. Last year, Heidrick used some of its cash hoard to buy Highland Partners for \$36.6 million in a deal that should add more depth to its financial services practice. More could be on the horizon, says Kelly: "We're always looking at ways to invest that cash to return value to shareholders." ■

L. KEVIN KELLY has overseen a 37% rise in Heidrick stock despite fear of a recession



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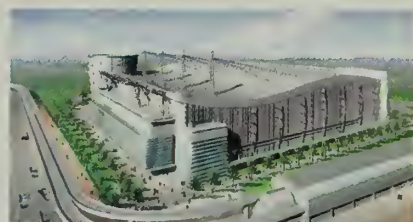
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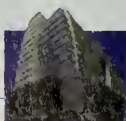
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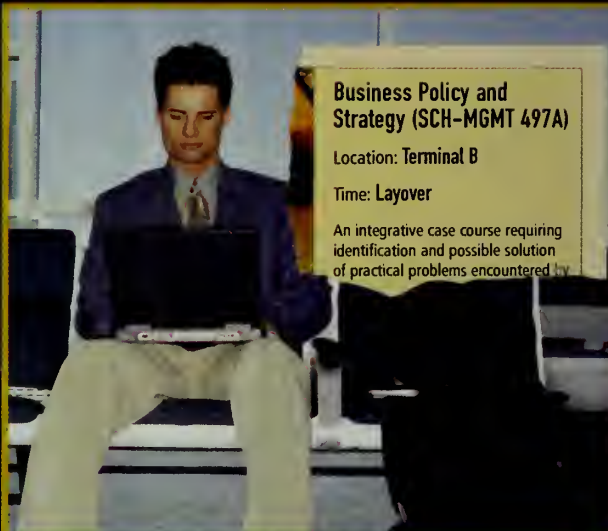


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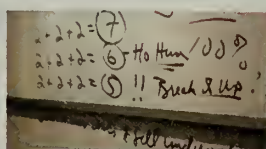
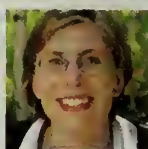
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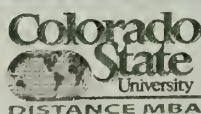
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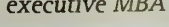
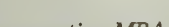
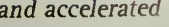
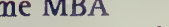
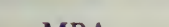
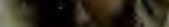
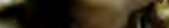
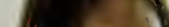
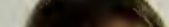
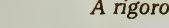
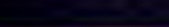
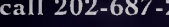
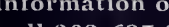
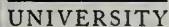
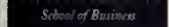
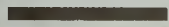
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Meet the Big Commuters On Campus

Executive MBA programs were intended for locals, but students from all over are enrolling. **BY JANE PORTER**



CHARLA SERBENT WANTED a Wharton MBA badly enough that she was willing to commute to school every other weekend between Shanghai and San Francisco. That was 10½ hours there, 13½ hours back. Given the magic of time travel across the international date line, she arrived at the West Coast campus of the University of Pennsylvania's Wharton School 4½ hours before she boarded the plane back home. "When you're traveling over multiple time zones, you're studying and not feeling great," says Serbent, who is general manager for PPG Industrial Coatings' Asia Pacific office. "All of a sudden your MBA becomes a physical task."

A growing number of executives like Serbent are forking over weekend time to earn an MBA and commuting sometimes astronomical distances to do it. While weekend executive MBA programs were designed as a convenience for local executives who couldn't miss work for school, EMBA students are increasingly drawn from afar. According to the Executive MBA Council, 22% of EMBA students travel 100 miles or more, up from 11% two years ago. Those with international commutes jumped from 2% to 4%. EMBA students routinely fly to the U.S. from Korea, China, Singapore, and Bahrain for programs at Wharton West, the University of North Carolina, and Columbia University.

As Serbent's plane touched down at San Francisco International Airport, Vishal

Verma could have been heading out door of his Los Altos home for a minute drive to Wharton West. Instead the 32-year-old partner in venture capital firm Edgewood Ventures opted to travel nearly 1,800 miles to EMBA classes at the University of Chicago. "I wanted to get a whiff of the world outside of Silicon Valley," says Verma, who typically caught 11:50 p.m. red-eye on alternate Thursdays before graduating in March. Like Serbent—who had been known to make a round-trip from Shanghai to Seoul in five days on business trips, with stops in Melbourne, Hong Kong, and San Francisco along the way—Verma often scheduled classes around business trips to India, traveling 14 hours from Chicago to do so.

To make it work, big personal sacrific



SOFT LANDING

Students grab a bite at Wharton West in San Francisco

Santa Clara after noticing unsolicited interest from West Coast students like Verma last year, says Director Patricia A. Keegan. To accommodate its globe-trotting clientele, the B-school hired a full-time staffer in November to work on EMBA student services such as airport shuttle coordination and hotel lodgings.

FREQUENT FLIER

A SATURDAY/SUNDAY schedule is one reason Guru K. Prabhu, a service delivery manager at Bank of America's Concord (Calif.) office, decided to go to Cornell University—despite a six-hour one-way commute by air and rental car to the EMBA campus in Palisades, N.Y., every other weekend. In nine months, Prabhu has earned enough frequent-flier miles to circumnavigate the globe 16 times. If he's delayed, his microeconomics professor will videotape the 8 a.m. class—a service he has needed only once.

For Prabhu, out-of-pocket costs will amount to about \$24,000 for travel and \$120,000 for tuition at the end of his two-year program. But Prabhu expects a rebate in the form of bonuses, raises, or full expense coverage from his next employer, an increasingly common practice.

For Serbent and Verma, their companies paid for much of the air fares and hotels, since most of the travel was sandwiched between business trips.

The road warrior lifestyle on top of tuition and travel costs are the price Prabhu is paying for a chance to advance his career. "People call me crazy," he says. "Once

you know what your ambition is, the rest follows." It's Serbent's mantra, too. Before graduating, she took each class as it came, one day at a time. "Before you know it," she says, "you're on your last day in San Francisco, and there you go." Just in time for a well-deserved nap and a flight back home. ■

Wedging in a 10-hour trip to class isn't so uncommon

cut Eastman Kodak's Rochester (N.Y.) staff from 28,100 in 1998 to 12,500 last year, the University of Rochester was hit hard. The company once sent 15 students a year to Rochester's EMBA program. This year it sent none. In September the program shifts from a weekly to a biweekly format, in an effort to attract students from afar who were unwilling to make a weekly trip. Another incentive: Students can get airfare and hotel discounts through partnerships with JetBlue Airways and Holiday Inn Hotels & Resorts.

Similarly, the University of Chicago began recruiting for its weekend EMBA program in San Francisco, Seattle, and

often required. For Marcus Goddard, who traveled seven hours door-to-door from his New Brunswick (Canada) home to Durham, N.C., for Duke University's MBA program, time with his wife and three kids was the first casualty of B-school. The 52-year-old business developer for Irving Oil, an energy company based in St. John, wasn't around for bike rides, homework, school plays, or Easter. His wife, Jennifer, "was basically a single parent during the weekends," says Goddard, who graduated in November.

INCENTIVES

NOT JUST the Whartons and Dukes are reaching out to distant students. MBA programs across the board are widening their recruiting efforts. When layoffs

An MBA, on The Family Plan

How B-schools help families relocate—or manage being apart

BY GEOFF GLOECKLER



ADDISON HEARD USES an image of his wife and infant son for the background on his laptop. An MBA student at the University of Virginia's Darden School of Business, Heard thinks about his family constantly. But because he's away at B-school, he has experienced much of his son's first year via phone calls and digital photos. Says Heard: "It has been particularly hard, not being there with them every day."

This was his family's choice. It didn't make financial sense for his wife, Eden, a corporate lawyer in Washington, to quit her job, sell their condo, and move to Charlottesville with her husband. So he went alone. In his first year each spouse made the 200-mile round-trip commute on alternate weekends. Since their son was born last May, Addison has been doing most of the driving.

As complicated as the Heards' situation seems, it isn't all that rare. In any year, hundreds of couples deal with how to handle the family logistics of going to B-school. Some choose a long-distance relationship, commuting back and forth on weekends and breaks. Others see partners and children only on vacations and holidays. Still others pack up the family and bring them along.

Being apart hasn't been easy, but the Heards have made it work. On week-

ends when the couple is in Virginia, they attend social events, so she can feel a part of the community. Heard also avoids Friday classes to gain more family time. "We've gotten into a routine that works," he says, "but I'm looking forward to being home, so the three of us can be a family."

Any long-distance commute puts pressure on a relationship, causing some couples to drift apart. Throw in a rigorous academic schedule for one spouse and a demanding career for the other, and the stress intensifies, often distracting students from their studies.

Some schools offer students in these situations a good deal of support. For faraway spouses, there are on-campus social events

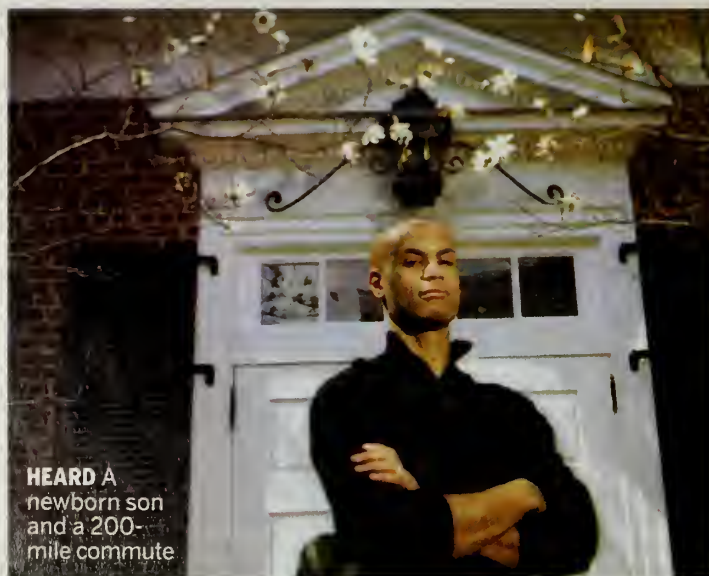
when they visit, online community even involvement in alumni networks in their home cities. But mainly B-schools try to make it easier for students to find their partners along for the ride. They help families find housing, preschools, local employment. "We go out of our way to make sure they have all of the resources they need," says Amy Mitson, senior associate director of the MBA program at Dartmouth's Tuck School of Business.

The 110-member Partner's Group

at the University of Chicago's Graduate School of Business has been a major benefit for MBA student Ondrej Hrnčíř. He and his wife moved to Chicago last summer from the Czech Republic with their three young children. The Partner's Group introduced them to other new families in the area. "It helped us feel at home," Hrnčíř says. He was also assigned a mentor, who went above and beyond the call. "He would look at apartments for us and then send pictures and thoughts," Hrnčíř says.

The decision to attend a distant B-school is fraught with financial and logistical problems. Students also must decide if their families should stay or go. Either way, schools try to accommodate them. "We have more than our share to think about," Hrnčíř says. "It's a family-influenced choice." ■

Support can range from social events to online aid



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Today's Students: Living Large

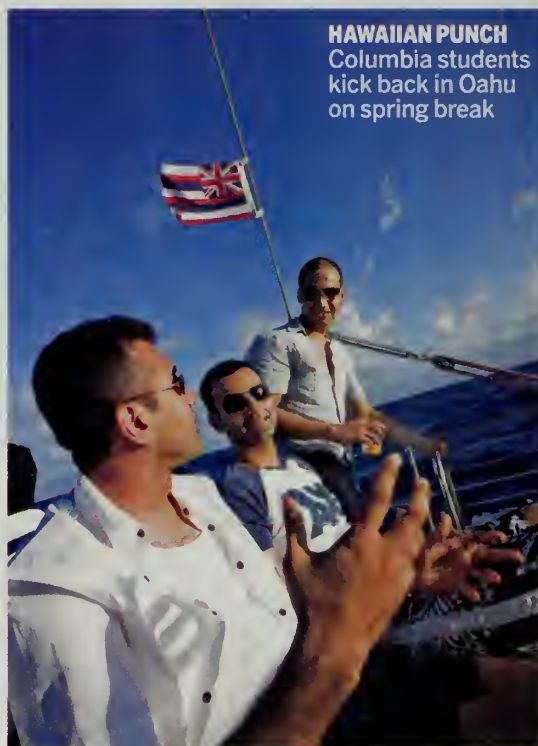
They're splurging like the high-paid executives they expect to become. **BY KERRY MILLER**

AN EPIDEMIC HAS HIT America's top MBA programs. At Harvard Business School, it's called FOMO: fear of missing out. Symptoms include a chronic inability to turn down invitations to any party, dinner, or junket attended by anyone who might be a valuable addition to one's network—no matter the cost.

With their incomes about to get a big boost at graduation, many students are spending far more than absolutely necessary, in part on luxuries like leisure travel and in part on networking events. Nobody wants to quibble over the costs when they're partying with folks who may advance their career. Says Mike Altman, a student at the University of California at Los Angeles' Anderson School of Management: "It isn't worth coming off as cheap or petty when you're building a network for life."

At top B-schools, where high-rolling investment bankers set the pace, those extras add up. Harvard suggests MBAs budget \$23,784 a year for room and board, but Harvard grads responding to a *BusinessWeek* survey last year estimated their annual living expenses at \$37,000, with more than 40 reporting \$80,000 or more.

Columbia Business School, where some MBA grads reported spending as much as \$85,000 a year, recommends that students budget about \$2,080 a month for room and board. But student Aakash Nijhawan says most people he



HAWAIIAN PUNCH
Columbia students kick back in Oahu on spring break

knows end up spending at least that much on housing alone, to live in the trendier precincts of Manhattan, such as Tribeca or SoHo, in an apartment "that's not the size of a shoebox."

The B-school set doesn't stint when it comes to travel, either. There's the winter "learning experience" in China, spring break in the Caribbean, and weekend jaunts to Vegas or Vail. The wine-tasting

trip to Napa, sponsored by the University of Chicago Wine Club, and the celebrity-spotting excursion to Cannes, offered by UCLA's Entertainment Management Assn., are not to be missed. And who could turn down an invite from a University of Chicago club to break bread with the Sa of Omaha himself, Warren Buffett?

REFORMED CHEAPSKATE

FOR NIJHAWAN, who will return to investment banking at graduation, that's no-brainer. "When you work in banking you're working really hard, and sometimes vacations get canceled," he says. That's how he rationalized spending \$5,000 for a student trip to India and about \$1,500 for

a spring break in Hawaii—quite a bit more than the \$3,900 a year Columbia recommends students budget for "personal expenses" including travel and clothing.

When he graduates in May, Nijhawan hopes to spend the summer in Greece and the Bahamas before starting his new job at Citigroup. With the money he stands to make there—the median starting salary for Columbia grads in his field is \$125,000—he's not worried about paying back loans. In fact, with what he's managed to save before starting school, he probably could have paid for it all in cash. Still, he wasn't ready to give up the high life. "I wanted to live more comfortably," he says, "and I budgeted accordingly." While he gave up the Brooks Brothers shopping sprees and \$300 dinners, he kept his spacious 1,200-square-foot apartment in Hoboken, N.J., and a

stylish BMW 325i.

UCLA's Altman, a onetime member of the U.S. national rowing team, considers himself "a bit of a cheapskate." Even so, Altman eventually realized that with the \$40,000 he was spending each year on tuition, it made no sense to pirate pennies. "I made such a huge financial commitment," he says. "I need to get as much out of this as I can." ■

A MOUNTAIN TO CLIMB OR A SUMMIT TO REACH?

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BY ROBERT PARKER

Expect a Line For Loire 2005

THE LOIRE VALLEY, by far France's largest wine-producing region, stretches across the country from the warm foothills of the Massif Central to the windswept shores of the Atlantic Ocean in Brittany. The region is best known for its white wines—sauvignon blancs and chenin blancs that seem to hit heights of finesse and elegance. ¶ On a recent trip to France, I gorged on oysters, shellfish, and fresh fish in Paris, meals made all the more enjoyable because they were accompanied by a number of unbelievable Loire wines

from the 2005 vintage. Great vintages are few and far between in the Loire, and while 2002 was one, 2005 may be even better because of the combination of concentrated flavors, extraordinary aromatics, and crisp acidity and minerality.

These zesty wines are just hitting the market now, but they're likely to disappear quickly because of their high quality. Here are three notable winemakers that should be on your shopping list. I've also identified two worthy labels in the Sancerre and Saumur-Champigny appellations. There's a wide price range in these wines, from as little as \$10 to as high as \$75.

Didier Dagueneau

Winemaker Didier Dagueneau makes outstanding dry sauvignon blancs in Pouilly-Fumé. Look for the Pur Sang and Cuvée Silex, wines of extraordinary minerality, richness, full-bodied power, and intensity. They are among the most expensive dry whites of the Loire, but they are truly great wines.

Domaine des Baumard

Check out the dry chenin blancs from the appellation of Savennières, probably the most underrated dry white wine in the world. The Savennières Clos du Papillon has gorgeous notes of honeyed oranges, nectarines, and citrus. Hints of almonds, chalk, and honeysuckle are also apparent. This is one of the few dry whites from the Loire that can last more than a decade.

Domaine Huet

Try Le Haut Lieu-Sec and Le Mont Sec, both from Vouvray. These wines should appeal to

those who enjoy exceptionally dry, honeyed notes of chalk, spices, and lemon grass in a medium- to full-bodied, incredibly intense wine. They should age beautifully for four to five years.

Sancerre

In most Paris bistros, the dry sauvignon blancs from the Sancerre appellation are enormously popular. Some of the best in class come from Domaine Alphonse Mellot Hippolyte Reverdy, Domaine Thomas et Fils Henri Bourgeois, and Edmond Vatan. For an earthy, full-bodied, intense Sancerre, look for the Pascal Cotat.

Saumur-Champigny

In this lesser known yet emerging appellation, the wines are getting better all the time. Look for bottles from Clos Rougeard, Château de Villeneuve, and Domaine de la Roche Neuve. ■

Robert Parker is the world's most influential wine critic. Visit eRobertParker.com to see tens of thousands of tasting notes, buy his books, or subscribe to his newsletter, The Wine Advocate.



VOUVRAY
Harvest
time at
Domaine Huet

For more Parker columns, go to businessweek.com/extras.

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Philosopher of Risk

Author and high-powered investment adviser Peter Bernstein holds forth on low rates, rising volatility, and the surprising reliability of equities



PETER BERNSTEIN is the financial market's leading philosopher of risk. The octogenarian Bernstein, long an adviser to institutional investors, is known to a wider audience through his books explaining how modern financial theory operates in today's capital markets and how we can use it to shape our own investments. Among his best-known are 1992's *Capital Ideas*, an examination of how concepts developed in academia transformed Wall Street, and *Against the Gods*, a sweeping history of risk and return in the financial markets, published in 1996. *Capital Ideas Evolving*, a follow-up to the 1992 work, comes out this month. Contributing Editor Christopher Farrell recently caught up with Bernstein. The following are excerpts from their chat:

How do you define risk?

My definition is not mine, but I like it. It's from Elroy Dimson at the London Business School: Risk means more things can happen than will happen. That means you don't know the limits of what can happen, but you still have to make decisions. So you manage risks by comparing them to potential returns, either through diversification. Remember, just because more things can happen than will happen doesn't mean bad things will happen. The outcome can be better than you expect. Maybe a stock I own will triple.

Does that perspective on risk affect how you look at today's market?

It affects how I look at the markets anyway. It's difficult to assess the range of possible outcomes. I used to do scenario forecasts—four or five possible outcomes, put probabilities on the forecasts, and they would add up to 100%. But that's not true because there is always something you didn't think of. When you're gambling, you do have the range of outcomes. In the markets, you don't.

How worried are you about the subprime mortgage market?

I'm worried, but I don't think the subprime market will upend the apple cart. The problems are too well-known.

After a February 9% drop in the Chinese stock market sent equity prices sharply lower around the world. Why?

The story is full of things like that, but globally there is more of a buildup. There was a week of significant decline before the 1987 market crash. There were declines before the 1929 crash. This time the market wasn't doing much—and then bang. Then again, investors seemed more complacent about market risk at that time around.

Why so?

I have a sense that people have rational-

ized this as a period of low interest rates, low returns, and low risk. Investors are seeking higher returns and not worrying about it because we're in a low-risk environment. But we could also be in a low-return environment because we have overvaluation of assets.

I think what happened to the Chinese market, although peripheral in world markets, was a wake-up call that investors have been underestimating market risk everywhere.

Where did the idea come from that we are living in a world of low returns?

It started after the crash of 2000-2001, when we entered a period in which the rate of inflation seemed to be low and under control and likely to remain so because central bankers everywhere are hawks on inflation. A low-inflation environment relieves some uncertainty about the future, and less uncertainty encourages investors to make longer-term bets. In an environment where risks are low, the returns should be low, too.

In search of higher returns, a lot of investment pros went into alternative investments where expected returns are higher, and so are the risks. You see it in emerging-market returns. Now, some of this is justified by the fundamentals. These are no longer just emerging economies. They are part of the global markets. That said, the enthusiasm for these markets was overdone.

What role are financial derivatives playing in all of this?

The fall in 2000-2001 was a big one, but the financial system didn't blow up. The typical failure of institutions did not occur. I kept waiting for it to happen. It may be that the derivatives business did spread the risk. I don't know whether that will be the case the next time.

So the derivatives are a big plus?

Derivatives have become quite complicated, and there are a lot of inexperienced players using them. Here I worry.

You recently wrote that over the long term, stocks are fundamentally less risky than bonds. Doesn't that fly in the face of conventional wisdom?

Stocks are less risky in this sense: So long as a capitalist system persists and the financial markets hold together, equities do have a built-in long-term rate of return. That rate of return is a nominal measure of the economy. In other words, if the economy continues to grow, there is in the long run a positive return to equities. Bonds, on the other hand, are victims of inflation surprises. And you can't say there won't be an inflation surprise.

Why don't investors expect a higher return from bonds than from equities?

The reason is that a bond is a contract. It specifies a moment when the issuer has to repay the money. If a bond gets into trouble, the terms of the contract give bondholders some power and choice, since bondholders get paid back first. In sharp contrast, there is infinite uncertainty with equities. Equities are a claim on uncertain future earnings.

Tell us more about *Capital Ideas Evolving*.

The big story in the original book was how the guys in the Ivory Tower figured out what markets and investing are about. Ideas like the trade-off

between risk and return, the efficient-market hypothesis, and diversification. But implementation was limited when I wrote the book. Now everyone is doing it—people like Nobel laureates Robert Merton and Bill Sharpe, Andrew Lo at MIT, Bob Shiller at Yale, all the big finance thinkers are making money from their ideas.

But what about the idea that markets are efficient and can't be beaten?

The efficient market is the benchmark. All these guys say how difficult it is to beat the market and that it's getting more difficult. David Swensen [chief investment officer for Yale University's endowment fund] went the unconventional route into alternative investments because he thinks conventional markets are too efficient. They're all aware of the limits of active management. They're trying to beat the market, and the ones I write about did it. ■

"You can't say there won't be an inflation surprise"



A One-Stop Shop For Stock Chat

InstantBull collects posts from SiliconInvestor, Yahoo! Finance, and more—fast. **BY LAUREN YOUNG**

STOCK JOCKEYS ALWAYS want to know the lowdown on companies. Yet keeping tabs on gossip about your holdings, or even about your own company, can be a full-time job. Different message boards attract different blabbermouths: day traders, do-it-yourself investors, even disgruntled employees. To complicate matters, each message board may feature multiple threads on the same company. That's why Gal Arav, a 35-year-old

software geek, created InstantBull.com, a stock-talk aggregation site.

Since it launched last July, InstantBull has tracked more than 100 million message-board posts from major chat sites, including ClearStation, InvestorsHub, InvestorVillage, RagingBull, SiliconInvestor, Yahoo! Finance, and Google Finance. And, as the name suggests, InstantBull does it fast. "Investors are the ones who appreciate the speed of access," Arav says. "They want the latest buzz on a stock."

InstantBull's nifty All-in-One feature unveiled in February, lets users type in a stock's symbol and see real-time chatter. Scroll to the left side of the InstantBull page (do not click), and the full message appears in the main window.

Overall, the site isn't much to look at, but it is speedy. When Google announced fourth-quarter earnings Jan. 31, InstantBull was collecting posts per minute in the hours following the release, according to Arav. That's impressive, but not all of those posts are going to be useful.

WORK AROUND THE SPAM

IN FACT, ONE DOWNSIDE is that the site can't filter out spam and other irrelevant material. Sandwiched among recent postings about Apple's introduction of AppleTV were religious messages as well as a plea to support Hillary Clinton's Presidential campaign. What's more, Motley Fool's busy members-only board are notably absent from the group.

You can still find plenty of good, so-called intelligence about companies on InstantBull. In addition to the posts about spin in volume, investors can read details about how Accredited Home Lenders Holding, a troubled mortgage insurer, secured a \$200 million loan. Also noteworthy is InstantBull's "Hot" list, which tracks the most-talked-about stocks. Recently those included Sirius Satellite Radio and Goldman Sachs. The Hot button on the top left corner of the home page will take you to an alphabetical list of ticker symbols. The ones that appear in the largest typeface are generating the most comments. This setup is a bit clunky, but you get the idea.

More useful is InstantBull's Buzz Matrix, which shows the number of company-specific postings on different message boards. The site tracks the number of messages that appeared in the past minutes, half-hour, or hour, which clue you in to market-moving news. After the New York Stock Exchange received regulators' blessing for a corporate bond trading system on Mar. 23, 40 comments were posted within an hour.

More buttons at the top left of the home page let you delve deeper. "Blog" offers a list of more than 100 financial blogs. You can even do a comprehensive search of the blogs by ticker symbol. Investors can also find links to stand-alone financial fare.

Right now the site is free. But Arav hopes to attract enough loyal users who will think it's worth paying for the intelligence InstantBull provides. ■



BY GENE G. MARCIAL

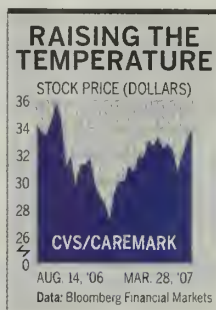
MERGING MAY MEAN MORE ROBUST HEALTH AT CVS/CAREMARK.

EXPONENT TAKES ON MORE LITIGATION AND REGULATORY WORK.

A NEW DRUG IS SHOWING PROMISE AT ACORDA THERAPEUTICS.

Deal to CVS/Caremark

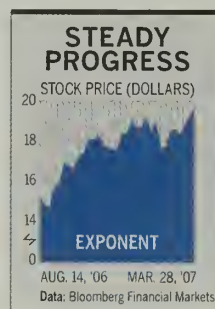
DEAL OR NO DEAL, CVS was already a fave on Wall Street. And now that it has acquired Caremark Rx, No. 2 in pharmacy-benefits management, Goldman Sachs, UBS, and Matrix USA are even more bullish. CVS is the U.S. drug chain with the most outlets, and the combined company has been renamed CVS/Caremark Inc. "We see the stock rallying not only for the long term but in the next months as well," says Goldman's Brian Heinbockel, who upped his 12-month target for CVS, now at \$33.98, from \$29 to \$43, with a buy rating. He also raised his 2008 earnings forecast to \$2.50, from \$2.30 a share, and his 2009 estimate to \$2.60. His 2007 estimate is unchanged, at \$1.88. These figures are based on expected boosts in revenues from the merger: from \$54 billion to \$76 billion in 2007, from \$54 billion to \$91 billion in 2008, and from \$58 billion to \$99 billion in 2009. In 2006, CVS earned \$1.56 a share on \$43.8 billion. William Miller of UBS upgraded CVS to a buy even before the deal. "I said he would raise his price target from 42 to 46 once the merger was O.K.'d. Ivan Feinseth of Matrix sees the current 6.3% return on invested capital doubling in a year or so. "Operating profits will pick up," he says, "and cost savings will kick in." CVS completed the deal on Mar. 22 and paid \$27.2 billion for Caremark, which contracts with outfits for employers or labor unions to manage their prescription drug plans. It earned \$1.1 billion in 2006 on \$36.7 billion.



Exponent: A Rising Power Consulting?

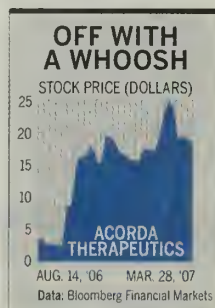
EXONENT (EXPO) is a real problem solver. It's a scientific and environmental consulting firm with clients in the automotive, energy, health-care, and government fields. Its stock, reflecting the small outfit's success, has bolted from 14 in August to 19.52 on Mar. 26. It's an unusual company with a franchise in litigation support, which is an attractive growth industry," says David Sowerby, portfolio manager at Loomis Sayles, which owns shares. Exponent is involved in high-profile cases, such as litigation over the "Big Dig" in Boston and Hurricane Katrina in New Orleans. Some 65% of revenue comes from

litigation support and 25% from design and regulatory work in science and the environment. The rest is from Defense Dept. projects. Sowerby notes revenues grew every year since 1993 and earnings since 1998. Both should speed up again, he says, as Exponent gains new projects. David Gold of investment firm Sidoti rates the stock a buy, with a 12-month target of 26. He sees profits of 93¢ in 2007 and \$1.06 in 2008, up from 83¢ in 2006.



Acorda Tackles Multiple Sclerosis

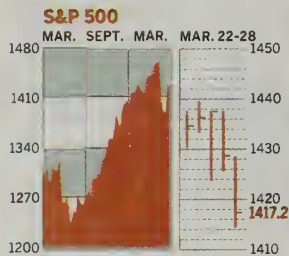
ACORDA THERAPEUTICS (ACOR) isn't your typical biotech. Even before its public debut in early 2006, the company had a commercial product. Zanaflex treats spasticity or muscular spasm, a condition associated with multiple sclerosis. Acorda's newer product is Fampridine-SR, which alleviates walking disabilities caused by MS. Shares of Acorda have been on a tear since Fampridine's first phase III trials yielded "strong data," says Phil Nadeau of securities firm Cowen. The patients involved showed "consistent improvement in walking speed," he says. About half of all MS patients will need help in walking within 15 years of their diagnosis, says Nadeau, who rates the stock "outperform." He expects Fampridine to be on the market by 2009, with \$120 million sales in 2011. The drug will undergo a second phase III trial this spring. Results of the first phase III will be released at the May 2 meeting of the American Academy of Neurology. That may fire up the stock again as more details about the trials become known. Caroline Stewart of Piper Jaffray rates Acorda, now at 18.69, a buy, with a 12-month target of 30. She estimates the market for Fampridine at \$450 million a year and for Zanaflex at \$35 million. ■



BusinessWeek.com

ONLINE: Gene Marcial's Inside Wall Street is posted at businessweek.com/investor at 5 p.m. EST on the magazine's publication day, usually Thursdays. **Note:** Unless otherwise noted, neither the sources cited in Inside Wall Street nor their firms hold positions in the stocks under discussion. Similarly, they have no investment banking or other financial relationships with them.

STOCKS



COMMENTARY

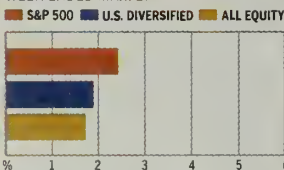
The market sank after weak economic news depressed investors. In February, new home sales fell 3.9% and durable goods orders weren't as strong as expected. Consumer confidence dropped by four percentage points in March. As if that weren't enough, the Fed chairman testified he's still focused on inflation, dashing hopes for a near-term rate cut.

Data: Bloomberg Financial Markets, Reuters

MUTUAL FUNDS

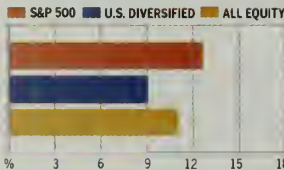
4-WEEK TOTAL RETURN

WEEK ENDED MAR. 27



52-WEEK TOTAL RETURN

WEEK ENDED MAR. 27



Data: Standard & Poor's

U.S. MARKETS

	MAR. 28	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P 500	1417.2	-1.2	-0.1	9.6
Dow Jones Industrials	12,300.4	-1.2	-1.3	10.3
NASDAQ Composite	2417.1	-1.6	0.1	4.9
S&P MidCap 400	847.4	-0.5	5.4	8.2
S&P SmallCap 600	410.6	-0.7	2.7	5.7
DJ Wilshire 5000	14,314.8	-1.2	0.7	9.6

SECTORS

BusinessWeek 50*	803.0	-1.0	0.6	4.4
BW Info Tech 100**	441.6	-1.7	-1.3	13.2
S&P/Citigroup Growth	649.0	-1.1	-0.5	6.5
S&P/Citigroup Value	767.1	-1.4	0.4	12.7
S&P Energy	465.0	3.0	2.1	14.7
S&P Financials	476.2	-2.8	-3.9	8.7
S&P REIT	201.8	-3.4	1.5	16.3
S&P Transportation	263.3	-1.7	-0.2	-4.1
S&P Utilities	203.0	0.6	8.8	28.5
GSTI Internet	205.5	0.3	2.9	7.8
PSE Technology	883.3	-1.6	0.9	2.5

*March 19, 1999=1000 **February 7, 2000=1000

BEST-PERFORMING GROUPS

	LAST MONTH %		LAST 12 MONTHS %
Tires & Rubber	27.7	Tires & Rubber	123.6
Oil & Gas Refining	10.7	Divsfd. Metals & Mining	52.5
Divsfd. Metals & Mining	8.2	Power & Energy Traders	44.3
Oil & Gas Equipment	8.1	Steel	44.1
Agricultural Products	7.2	Constr. Materials	34.8

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Latin America	7.6	Latin America	33.6
Natural Resources	5.1	Utilities	30.5
Utilities	4.2	Pacific/Asia ex-Japan	29.7
Communications	2.8	Europe	24.8
LAGGARDS		LAGGARDS	
Japan	-1.7	Japan	-1.5
Real Estate	-1.6	Health	2.1
Precious Metals	0.1	Small-cap Growth	3.4
Financial	0.3	Technology	4.0

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
DireXn. Lat. Am. Bull 2X Inv.	16.6	Dreyfus Prem. Grtr. China A	59.7
Profds. Ult. Oil & Gas Inv.	13.4	Old Mut. Clay Finlay Ch. A	48.8
DireXn. Emrg. Mkts. Bull 2X	12.6	iShares MSCI Malaysia Idx.	48.4
Profunds Oil Equip., Svcs.	11.5	Oberweis China Opport.	47.4
LAGGARDS		LAGGARDS	
DireXn. Emrg. Mkts. Short	-13.5	DireXn. Emrg. Mkts. Short	-40.7
Profds. UltSh. Oil & Gas	-12.2	DireXn. Dev. Mkts. Bear 2X	-29.6
Profunds UltSh. Emrg. Mkts.	-11.4	SPDR S&P Homebuilders ETF	-25.8
iShares DJ U.S. Home Constr.	-10.1	Frontier MicroCap	-25.0

GLOBAL MARKETS

	MAR. 28	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P Euro Plus (U.S. Dollar)	2043.6	0.8	2.7	2.2
London (FT-SE 100)	6267.2	0.2	0.7	
Paris (CAC 40)	5552.7	0.9	0.2	
Frankfurt (DAX)	6816.9	1.6	3.3	1.1
Tokyo (NIKKEI 225)	17,254.7	0.5	0.2	
Hong Kong (Hang Seng)	19,553.9	0.2	-2.1	2.2
Toronto (S&P/TSX Composite)	13,197.2	0.3	2.2	
Mexico City (IPC)	28,098.3	-0.4	6.2	4.1

FUNDAMENTALS

	MAR. 27	WEEK AGO	YEAR AGO
S&P 500 Dividend Yield	1.81%	1.85%	1.79
S&P 500 P/E Ratio (Trailing 12 mos.)	17.2	17.0	18
S&P 500 P/E Ratio (Next 12 mos.)*	15.3	15.1	15
First Call Earnings Revision*	0.13%	-0.24%	0.44

TECHNICAL INDICATORS

	MAR. 27	WEEK AGO	YEAR AGO
S&P 500 200-day average	1356.1	1351.9	Positi
Stocks above 200-day average	73.0%	70.0%	Negati
Options: Put/call ratio	0.98	1.11	Positi
Insiders: Vickers NYSE Sell/buy ratio	6.63	6.39	Negati

WORST-PERFORMING GROUPS

	LAST MONTH %		LAST 12 MONTHS %
Forest Products	-12.9	Homebuilding	-
Homebuilding	-11.8	Electric Mfg. Svcs.	-
Motorcycles	-11.6	Photographic Products	-
Electric Mfg. Svcs.	-8.5	Distillers & Vintners	-
Dvsfd. Commercial Svcs.	-7.9	Airlines	-

INTEREST RATES

KEY RATES

	MAR. 28	WEEK AGO	YEAR AGO
Money Market Funds	4.87%	4.86%	4.1
90-Day Treasury Bills	5.04	5.04	4.1
2-Year Treasury Notes	4.57	4.53	4.1
10-Year Treasury Notes	4.62	4.54	4.1
30-Year Treasury Bonds	4.83	4.72	4.1
30-Year Fixed Mortgage †	6.09	6.03	6.1

† BankQuo

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BONO	30-YR. BOND
General Obligations	3.77%	4.16
Taxable Equivalent	5.39	5.94
Insured Revenue Bonds	3.96	4.44
Taxable Equivalent	5.66	6.37

THE WEEK AHEAD

PURCHASING MANAGERS' INDEX
Monday, Apr. 2, 10 a.m., EDT » The Institute for Supply Management's manufacturing activity is forecast to have slipped back to 51.4% in March, after rising to 52.3% in February. That's the consensus among economists queried by Action Economics.

FACTORY INVENTORIES
Wednesday, Apr. 4, 10 a.m. EDT » Manufacturing inventories most likely grew by 0.3% during

February. In January, inventories declined by 0.2%.

NONMANUFACTURERS' INDEX
Wednesday, Apr. 4, 10 a.m. EDT » The Institute for Supply Management's March nonmanufacturing index probably rebounded to 55%, following a decline to 54.3% in February.

EMPLOYMENT Friday, Apr. 6, 8:30 a.m., EDT » March nonfarm payrolls are forecast to have increased by 135,000 workers,

after a gain of 97,000 in February, » the smallest in more than two years. The jobless rate probably rose a tick to 4.6%, after a surprising fall to 4.5% in February. Besides stronger hiring, average hourly wages and the average workweek most likely grew, too.

INSTALLMENT CREDIT Friday, Apr. 6, 3 p.m. EDT » Consumers probably added \$6.8 billion of debt in February, after a \$6.4 billion gain in January.

The BusinessWeek production index slid to 291.4 for the week ended Mar. 17, an 8.2% gain from a year ago. Before calculation of the four week moving average, the index improved to 291.3.

BusinessWeek .com

For the BW50, more investment data, and the components of the production index visit www.businessweek.com/extras.

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This index gives the starting page for a story or feature with a significant reference to a company. Most subsidiaries are indexed under their own names. Companies listed only in tables are not included.

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Thank You for Dying

BOOMSDAY A Novel

By Christopher Buckley; Twelve; 318pp; \$24.99

Have you heard the latest proposal out of Washington for fixing the Social Security mess? It's simplicity itself. As the baby boomers shuffle into their sunset years, Uncle Sam will hand them a bundle of juicy tax breaks and assorted perks in return for agreeing to a painless lethal injection at age 65. Too draconian? Not

to worry. A second option would give slightly less generous benefits to those who prefer to hang around to age 70.

Given the boomers' well-known love of tax-code manipulation, the idea has a certain irresistible logic. But as you've probably guessed by now, this is not a proposal you'll hear from any of the candidates currently running for top office. Instead, it's a plot device from the latest pitch-perfect political satire from Christopher Buckley. *Boomsday* follows squarely in the tradition of *Thank You for Smoking*, Buckley's earlier send-up of the tobacco lobby. Once again, he precisely captures that peculiarly Washingtonian flair for packaging naked self-interest as the national agenda.

Buckley sets his Swiftian tale more or less in the present. President Riley Peacham's foreign policy has devolved into chaos, inflation is spiraling out of control, and the national debt has reached epic proportions. As a beleaguered Fed ratchets interest rates up toward 15%, the body politic grows restless. Enter Cassandra Devine, a 29-year-old Washington public-relations executive by day and diva blogger by night, who rallies otherwise lethargic young Americans to a cause even they can embrace: that of forcing their parents to pay down the debt for their cushy government-subsidized retirements before the bill lands permanently around the younger generation's necks. After driving her frenzied followers into a series of riots outside gated retirement communities, Cassandra hits on the suicide scheme as a way to, as she puts it, get the ungreatest generation to finally give something back.

Cassandra's obsession with the sins of the boomers was sparked by her entrepreneur father who, years earlier, drained her college fund and mortgaged the family home, a fact she discovered just as she got her acceptance letter from Yale. Unabashed, he suggested she instead consider enlisting in the military. (Later, after his dot-com enterprise struck it rich and he embarked on marriage No. 2, he dropped \$25 million to persuade the gatekeepers at Yale

not to flunk out his drug-addled stepson, Boyd, adding to Cassandra's wrath.)

Cassandra's allies in her crusade are two familiar Washington types. There's her mentor, Terry Tucker, a spinmeister extraordinaire, and Randolph K. Jepperson IV, old-money WASP and junior senator from Massachusetts, who sees in the idea just the sort of out-of-the-box, youth-appealing proposal he needs to jump-start his Presidential bid. ("Cynical" doesn't do Buckley's worldview justice. In a particularly masterful touch, Jepperson confides that he was inspired to pursue a life of public service while dropping

acid as a youth in the JFK Presidential library.) Naturally, the pro-life lobby sees Cassandra's novel fix for Social Security as a heaven-sent opportunity to rally the troops. Its spiritual leader, the Reverend Gideon Payne, latches on to the issue as a launch pad for his own campaign for the White House. Now fully wound, the slight mechanical plot is set tick-tocking on its mostly hilarious way.

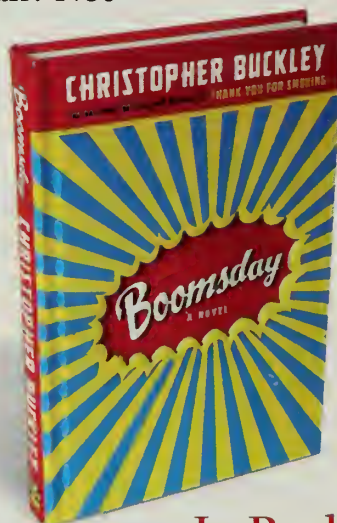
Buckley's real subject, of course, is neither Social Security nor intergenerational politics. As in his last novel, the subject is Washington, the place and the process, in all its glorious absurdity. Like all great satire, *Boomsday* is outrageous, but only slightly more so than real life. In a perfect parody of euphemism-laden bureaucrats

the mass-suicide-for-pay scheme becomes "Voluntary Transitioning." And since this is Congress, by the time the bill wends its way through the Senate it has been buried under a mountain of pork, including tax breaks on Segways for the arthritic and subsidies for Botox injections. Meanwhile, increasingly desperate President Peacham hands out promises of high-level appointments, ambassadorships, even the Vi

Presidency, like cheap cigars. And inevitably, the Reverend Payne is laid low—by a weakness for Russian prostitutes.

In Buckley's *Boomsday* universe, everyone is in permanent campaign mode (whether they're running for office or not), endlessly scheming and spinning their way to various tawdry ends. By the conclusion of the book, nothing much has changed among this cast of characters though plenty has happened along the way. Sort of like Washington itself. ■

—By Mary Kull



In Buckley's latest satire, a modest proposal for saving Social Security

The BusinessWeek Best-Seller List

HARDCOVER BUSINESS BOOKS			PAPERBACK BUSINESS BOOKS		
	LAST MONTH	MONTHS ON LIST		LAST MONTH	MONTHS ON LIST
1 FREAKONOMICS Steven D. Levitt, Stephen J. Dubner (Morrow • \$27.95) <i>Crack gangs, the Ku Klux Klan, and more, examined by a University of Chicago economist.</i>	3	23	1 GOOD TO GREAT AND THE SOCIAL SECTORS Jim Collins (Collins • \$11.95) <i>A primer on how noncorporate organizations can excel.</i>	2	15
2 JIM CRAMER'S MAD MONEY James J. Cramer with Cliff Mason (Simon & Schuster • \$25) <i>More investing wisdom from the television personality.</i>	1	3	2 START LATE, FINISH RICH David Bach (Broadway • \$14.95) <i>Strategies and tactics for baby boomers nearing the age of retirement.</i>	1	2
3 THE WORLD IS FLAT Thomas L. Friedman (Farrar, Straus & Giroux • \$30) <i>Globalization is great—sort of—says a columnist for The New York Times.</i>	2	22	3 CRUCIAL CONVERSATIONS Kerry Patterson, Joseph Grenny, Ron McMillan, Al Switzler (McGraw-Hill • \$16.95) <i>How to handle those all-important talks.</i>	7	13
4 WOMEN & MONEY Suze Orman (Spiegel & Grau • \$24.95) <i>Inspirational prose and practical tools to help females with their finances.</i>	—	1	4 QUANTUM SUCCESS Sandra Anne Taylor (Hay House • \$14.95) <i>The "science of success," as described by a psychologist and consultant.</i>	—	1
5 MADE TO STICK Chip Heath, Dan Heath (Random House • \$24.95) <i>An examination of why some ideas gain traction while others fade from view.</i>	7	2	5 A GUIDE TO THE PROJECT MANAGEMENT BODY OF KNOWLEDGE Project Management Institute (PMI Publications • \$49.95) <i>Delivering results.</i>	8	13
6 WORDS THAT WORK Dr. Frank Luntz (Hyperion • \$24.95) <i>A Republican spinmeister on how business can improve its communications.</i>	14	2	6 WHAT COLOR IS YOUR PARACHUTE? 2007 Richard Nelson Bolles (Ten Speed Press • \$17.95) <i>The enduring job-search bible.</i>	4	7
7 THE ONLY THREE QUESTIONS THAT COUNT Ken Fisher (Wiley • \$27.95) <i>A contrarian approach to investing, by a Forbes columnist.</i>	6	2	7 LEADERSHIP AND SELF-DECEPTION The Arbinger Institute (Berrett-Koehler • \$14.95) <i>A leader's motivation is what matters, says this business fable.</i>	—	9
8 THE STARBUCKS EXPERIENCE Joseph A. Michelli (McGraw-Hill • \$21.95) <i>How the coffee retailer succeeded.</i>	9	4	8 J.K. LASSER'S YOUR INCOME TAX 2007 The J.K. Lasser Institute (Wiley • \$17.95) <i>Time to start sorting receipts.</i>	3	3
9 JEFFREY GITOMER'S LITTLE GOLD BOOK OF YES! ATTITUDE Jeffrey Gitomer (Prentice Hall • \$19.95) <i>Accentuate the positive.</i>	4	3	9 THINK AND GROW RICH Napoleon Hill (Ballantine • \$7.99) <i>Willpower and a positive attitude are the essential elements of success.</i>	12	22
10 STRENGTHSFINDER 2.0 Tom Rath (Gallup Press • \$19.95) <i>Assessing your talents and putting them into practice.</i>	—	1	10 FLIP Rick Villani, Clay Davis (McGraw-Hill • \$21.95) <i>Finding, remodeling, and selling properties.</i>	—	1
11 OUR ICEBERG IS MELTING John Kotter, Holger Rathgeber (St. Martin's • \$19.95) <i>Dealing with change.</i>	12	5	11 THE GOAL Eliyahu M. Goldratt, Jeff Cox (North River Press • \$24.95) <i>A "business novel" on overcoming bottlenecks.</i>	—	5
12 WHAT GOT YOU HERE WON'T GET YOU THERE Marshall Goldsmith with Mark Reiter (Hyperion • \$23.95) <i>An executive coach on negative habits that can hurt careers.</i>	8	2	12 THE ERNST & YOUNG TAX GUIDE 2007 Ernst & Young LLP (CDS Books • \$16.95) <i>Sharpen those pencils and get out the W-2s.</i>	5	3
13 WIKINOMICS Don Tapscott, Anthony D. Williams (Portfolio • \$25.95) <i>Harnessing collaboration to make your company more innovative and profitable.</i>	—	1	13 THE ESSAYS OF WARREN BUFFETT Warren E. Buffett, Lawrence A. Cunningham (Cunningham Group • \$25) <i>A selection of epistles to Berkshire Hathaway shareholders.</i>	9	4
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LONG-RUNNING BEST-SELLERS

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GOOD TO GREAT Jim Collins (HarperBusiness • \$27.50)	RICH DAD, POOR DAD Robert T. Kiyosaki with Sharon L. Lechter (Warner • \$16.95)	GETTING TO YES Roger Fisher, William Ury, Bruce Patton (Penguin • \$15)
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WHO MOVED MY CHEESE? Spencer Johnson (Putnam • \$19.95)	THE 7 HABITS OF HIGHLY EFFECTIVE PEOPLE Stephen R. Covey (Free Press • \$15)	SMART WOMEN FINISH RICH David Bach (Broadway • \$14.95)
INK Malcolm Gladwell (Little, Brown • \$25.95)	THE E-MYTH REVISITED Michael E. Gerber (HarperBusiness • \$16)	THE MILLIONAIRE NEXT DOOR Thomas J. Stanley, William D. Danko (Pocket Books • \$15)
THE LITTLE RED BOOK OF SELLING Jeffrey Gitomer (Bard Press • \$19.95)	THE 48 LAWS OF POWER Robert Greene (Penguin • \$18)	SMART COUPLES FINISH RICH David Bach (Broadway • \$14.95)

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Reviews and more are available on www.businessweek.com.



Michael Oxley's Next Act

MICHAEL OXLEY is best known as the co-author of the Sarbanes-Oxley Act, the 2002 law that set new standards of accountability for company boards, management, and accounting firms—and led business to bemoan the financial burdens of compliance. Now the former Ohio congressman is working to win over business as NASDAQ's nonexecutive vice-chairman. He'll work with CEO Robert Greifeld and will try to entice companies to list on the exchange. I caught up with Oxley to talk about SarbOx, private equity, and American competitiveness.

Tell me what your role at NASDAQ will be and what you're expecting to accomplish.

I will be advising Bob Greifeld and the board on public policy issues, and I'll be meeting with a lot of the listed company CEOs and CFOs throughout the country. I'll try to better explain to the listed company members the role that Washington plays for good and for bad, and to develop some ideas [to] better serve them.

What can be done to reclaim financial-services business lost to overseas markets?

Well, first of all, I think [the problem] is a bit overstated. I don't think we could expect to be a monopoly forever. There are going to be more competitors. We just have to be better at it. I haven't talked to a CEO yet who doesn't relish the opportunity to be competitive in the global marketplace and go after that kind of business.

Do you worry about your reputation as an architect of Sarbanes-Oxley, a law many in business have complained about? Will that be a hindrance in terms of getting new business listings on NASDAQ?

Oh, I don't think so. I think there's a lot of misinformation about the law. Some changes in Section 404 [which requires companies to produce an annual internal-control report] will be very positive for the business community.

What kinds of changes to 404 might we expect?

You're going to see not a one-size-fits-all but a more tailored approach affecting the smaller companies. You're going to see some commonsense proposals coming out of the Securities Exchange Commission and the Public Company Accounting Oversight Board that will have the effect of bringing a lot of the excess costs out of the system, but maintaining the integrity of the system and protecting the investors at the same time.

But large companies also have complained about 404. In retrospect, was that section too harsh and costly for business?

I think 404 has obviously proved to be much more expensive than anticipated, and I think everybody agrees with that, and that's why the flexibility we put into the law allows the SEC and the PCAOB to make some of those changes. For example, their proposals will put much more of an emphasis on the internal audit as opposed to the external audit. You can make a good argument that most of the costs have been because of the external audit.

What are your thoughts on the private equity boom? Do you think we need to see heavier regulation?

No, I don't. I think private equity plays an enormous role in our economy that is somewhat misunderstood. Whether they're hedge funds or private equity concerns, they do a real service. In many cases, private equity firms take a company private, fix it up, dress it up, and put it back on the market for an IPO. We have enormous capital there that is almost uniquely American. If we want to regulate, say, the hedge funds, you would have to increase the budget of the SEC something like tenfold. I think that's rather unrealistic.

How worried are you about the subprime mortgage fallout? Do you think we could enter recession at some point this year?

It's always possible. But I don't think it's going to be driven by the subprime mortgage meltdown. The indication is it's a relatively small percentage in the overall housing mortgage industry and an even smaller portion of the overall economy.

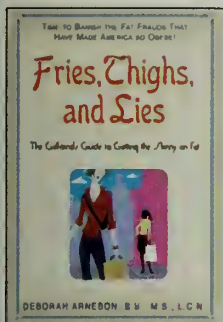
Maria Bartiromo is the anchor of CNBC's Closing Bell.



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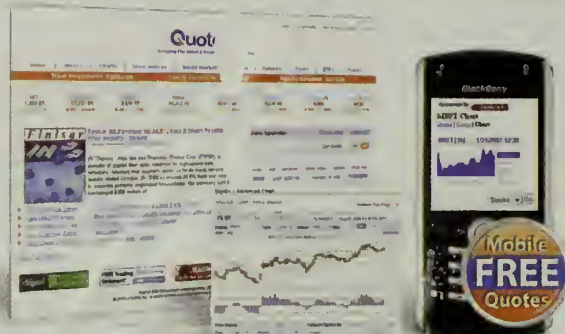
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Turning Blasé Into Buy-In

You talk a lot about passion being the key to success. Is passion innate or can it be ignited at any point in a person's career?

—Bob March, Fairfield, Conn.

Every one of us knows a few people (or more, if we're lucky) who are perpetually on fire. They're madly in love with their work, they're wild about college basketball or the hometown team, they go crazy over old jazz or modern art—whatever—they just pour their hearts and souls into life. And, given their unrelenting intensity, you can be pretty sure something innate is going on.

Let's not talk about them. Like people born with blue eyes or high arches, they are what they are. It's more useful to talk about the second part of your question: Can people actually go from blasé to burning hot? The answer is a resounding "yes," as every good manager already knows. Passion can indeed be ignited, but you must draw on your own inner fire, giving your people powerful answers to the questions: Where are we going? Why? And: What's in it for me?

Now, we realize it's probably hard to imagine these questions motivating the glazed-eyed employees who, sadly, populate too many companies, counting the minutes until they are free of managers who don't seem to care or make sense or both. But we've seen passion uncorked in even the most benumbed cubicle dwellers. Consider what happened at a business we're familiar with—let's call it Acme. Three years ago, Acme was an orphaned unit floundering inside an international manufacturer. Its profits weren't growing, and its people were about as motivated as hedgehogs in winter. Enter a private equity firm, which took Acme private. Critics, of course, focus on private equity's flaws, but one of its greatest virtues is that it can, and often does, transform an acquisition through zealous attention to people, rigorous execution, and fresh ideas. That's what happened at Acme. Yes, some employees were asked to move on. But for those who remained, many of them in their 50s and 60s, the new owners offered a vision of the future with a compelling upside for those who bought into it—new opportunities for career growth, financial reward, and just plain fun at work.

Fast-forward to an Acme business review that one of us recently attended. Instead of acting like a dreary collection of

clock-watchers, people were exchanging turnaround stories, boasting about productivity gains, and excitedly comparing notes on "attacking" previously untapped markets. The cynicism of the old days was replaced by optimism and genuine engagement. Clearly, employees who had once seemed passionless had learned the game, how they were supposed to be playing it, and how they would benefit if the team won.

Fortunately, you don't need a private equity investor to make that happen in your company. Even if you are managing just three people, the concept applies. Passion gets ignited by purpose. And it's every leader's job to make that purpose come alive. Paint the future in vivid colors. Before long, people who once looked bored may well burst into flame. They just need you to strike the match.

Does the subprime mortgage meltdown have the potential of bringing down the U.S. economy?

—Alan Marshall, Plymouth, Mich.

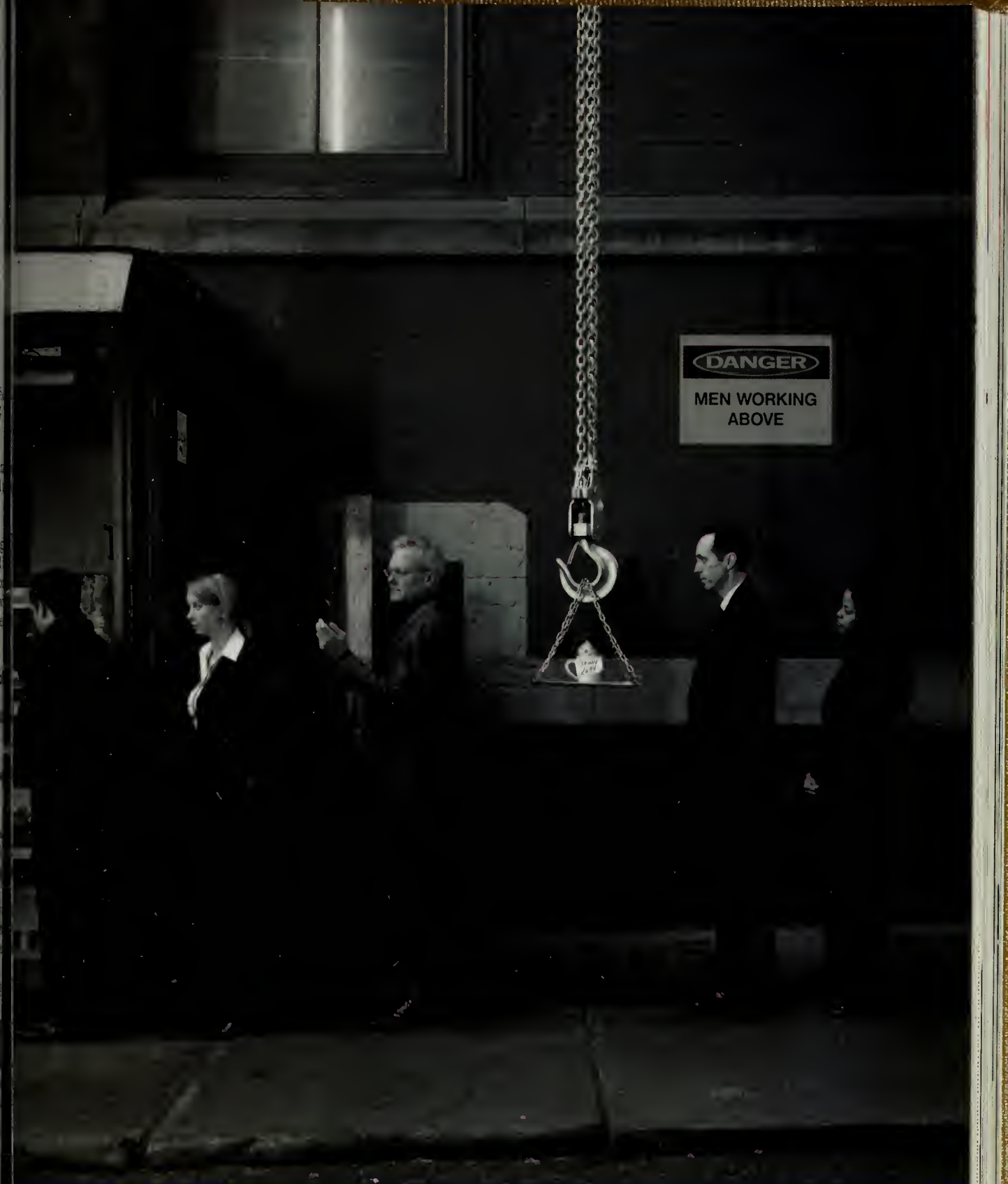
Meltdown is a good word for the unfolding subprime mortgage mess, but the answer to your question is still "no." This is not the savings-and-loan disaster of 1989, which helped send the U.S. economy into a recession. Today's economy is so much more broad-based and global, and its financial markets so much more liquid, that it can handle the relatively small problem without serious long-term damage.

Of course, the problem doesn't feel small to the people living with it. Thousands of families are being forced to move out of their homes and unload their properties, many of them saying they never understood that rising interest rates could destroy their dreams of homeownership. And employees of the companies that made the subprime loans are facing layoffs in a weakened industry.

Even with those disheartening stories, though, it is important to recognize that the subprime mortgage business is just a small percentage of a \$15 trillion national economy. Indeed, you can already see the economy's overall resiliency and liquidity in the activities of several investment companies, such as Goldman Sachs, that are buying up portfolios of subprime loans at distressed prices.

We're not saying the subprime crisis should be pooh-poohed. But even with its spillover effects—diminished consumer spending, for instance—it won't kill the economy. Think big blip, not blowout. ■

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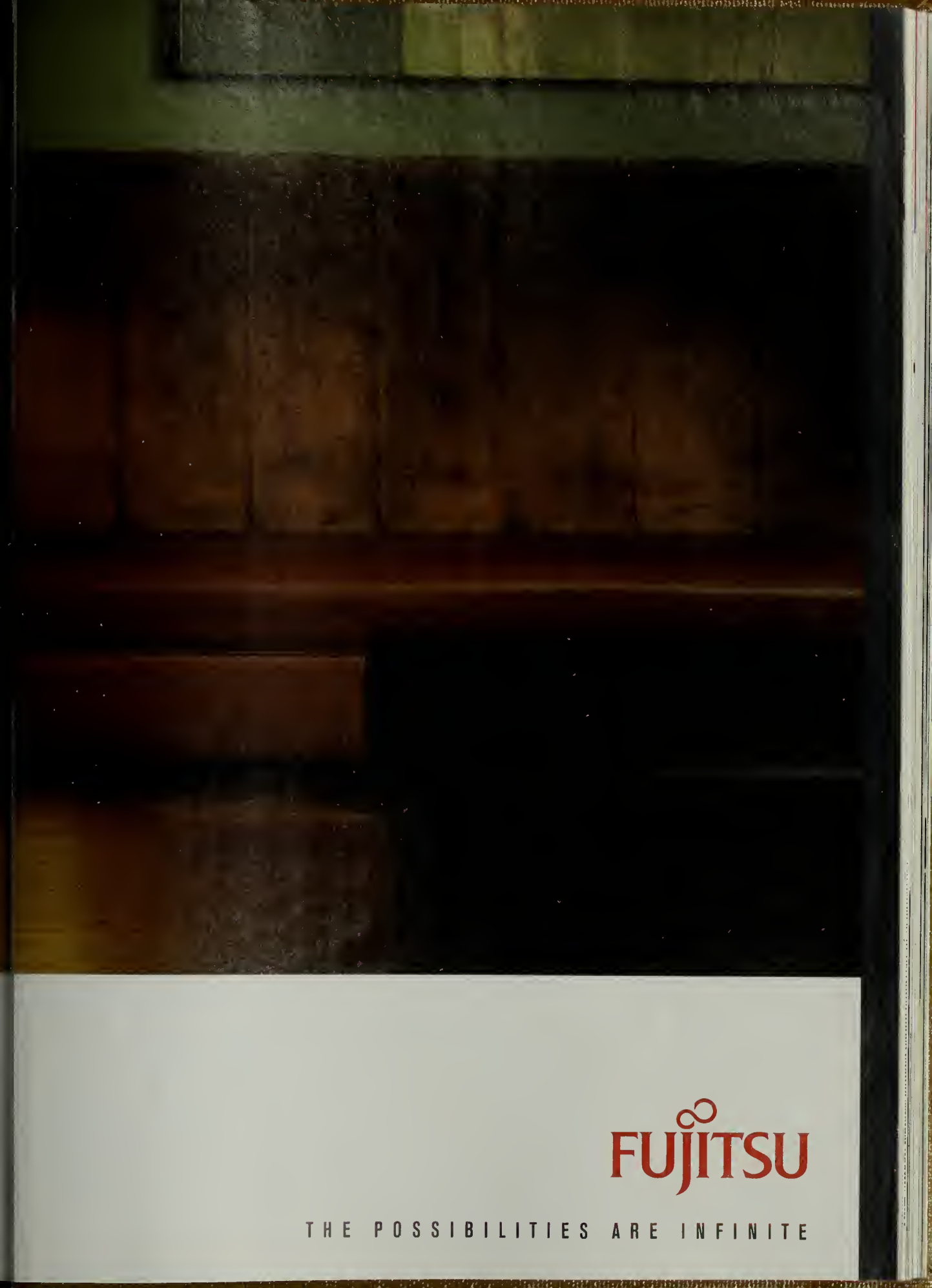
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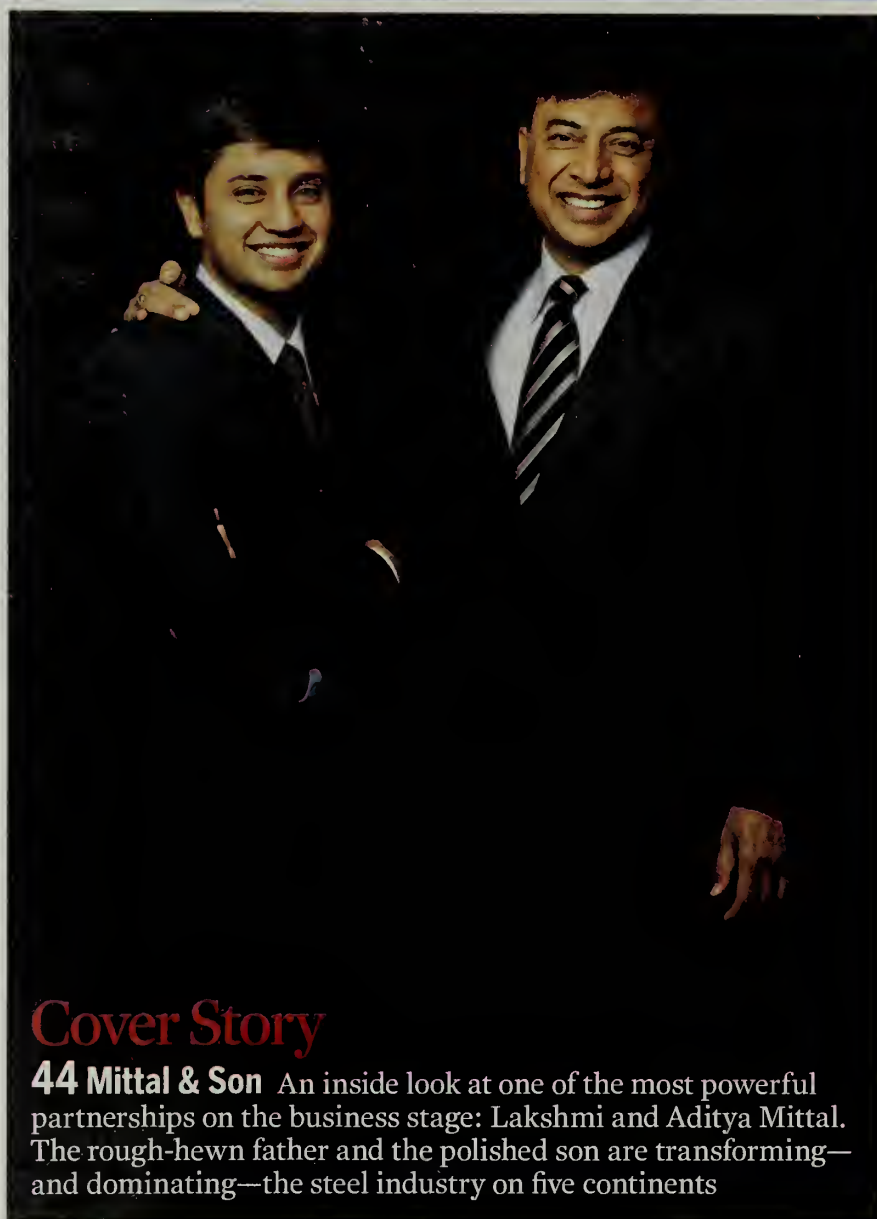
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n Cooper tells investors corporate
ret growth will slow

BusinessWeek (ISSN 0007-7135) Issue number 4030, published
except for one week in January, July and August, by The
Hill Companies, Inc. Executive, Editorial, Circulation, and
ing Offices: 1221 Avenue of the Americas, New York, N.Y.
Periodicals postage paid at New York, N.Y. and at additional
offices. Canada Post Publication Mail Agreement Number
01. Return undeliverable Canadian addresses to: DPGM Ltd.,
Bath Road, Mississauga, ON L4T 1L2. Email: bwkcustserv@
illment.com
ster: Send address changes to BusinessWeek, P.O. Box 8418,
g, IA. 51591-1418



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When it came to our tasting of "white goods," the superpremiums ruled the day. Here, our top three in each category, plus our tasters' comments:

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Entrepreneurial aces (clockwise from top left): Felix Miller and Richard Jones of Last.fm; Atlassian founder Mike Cannon-Brookes and Scott Farquhar; Motricity's Jud Bowman; Loopt CEO Sam Altman

Tech's Newest Hotshots

Jud Bowman had barely begun college at Stanford University when he started selling venture capitalists on the idea of downloading songs and ringtones to cell phones. Five years later at the ripe old age of 25, his company, Motricity, has raised more than \$200 million and is poised for an IPO. Bowman is in the vanguard of young entrepreneurs who are **extending the boundaries of the Web on mobile phones**. Read his story, and meet more than a dozen other 30-and-under innovators in BusinessWeek.com's annual report on the **Best Young Entrepreneurs of Tech**. Among this year's finalists, culled from a long list of nominees submitted by top venture capitalists and BusinessWeek.com editors, is Dalton Caldwell, CEO of Imeem. Imeem's Web site lets users view and share song and video playlists—and it's **shaking up the way artists put their music in front of millions** of would-be fans. The best entrepreneurs aren't just building a better Web; they're also striking out in other areas of tech. Cases in point: Seth Coe-Sullivan, who founded QD Vision to make **sharper, less expensive displays**, and Mike Cannon-Brookes and Scott Farquhar, the founders of Atlassian, who are developing software to help companies manage their work and communications. Go to www.businessweek.com/go/07/best for these stories and much more.

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"Should there be a divorce... we would be very happy."

—Henning Gephardt, a fund manager at DWS Investment, on the possible sale of Chrysler, a comment that drew applause during DaimlerChrysler's annual shareholder meeting.

EDITED BY MICHAEL ARNDT

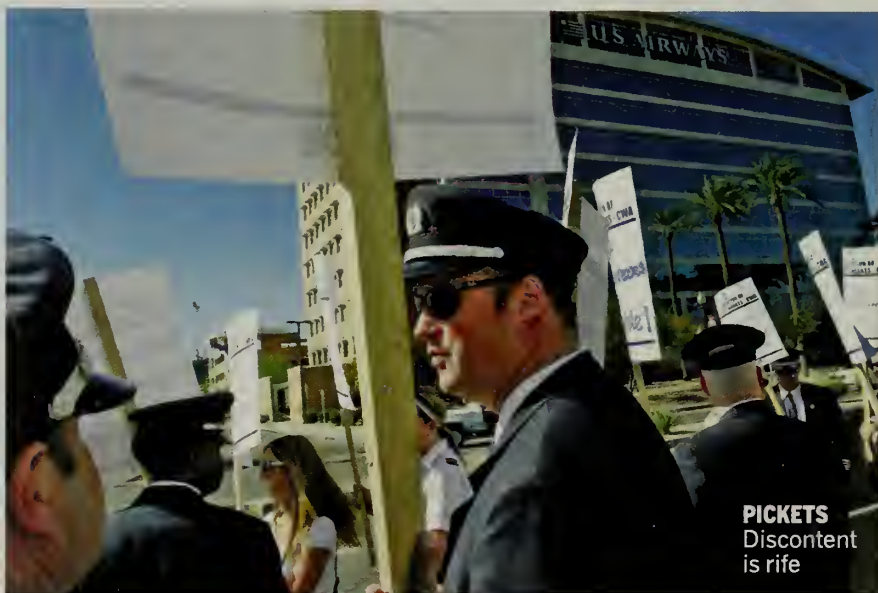
AIRLINES

Workers Say: 'We Want an Upgrade'

ON THE WEB SITE for the **Allied Pilots Assn.**, American Airlines pilots are counting down the days until Apr. 18. That's when parent **AA** is expected to award big bonuses to nearly 1,000 top managers. At noon the pilots plan to march a half-mile from their union office to the corporate headquarters in Fort Worth, shouting the way about how management is reaping upwards of \$180 million in bonuses while pilot pay has fallen during the past five years.

The good news is the airline industry is back in the black. The bad news—for airline execs and investors—is that workers want a bigger slice of those profits. Since the September 11, 2001, terrorist attacks, the airlines have done a tremendous job of cutting employee costs. Four of the nation's largest carriers declared bankruptcy, allowing them to break labor contracts and hand over pension liabilities to the federal government. Now passenger traffic and fares are up, and the industry netted more than \$2 billion in 2006, its first profitable year since 2000.

Almost every major airline will deal with labor strife this year. On



PICKETS
Discontent is rife

Mar. 27 five unions representing 30,000 employees at **United Airlines** announced they had formed a coalition to argue for better pay and working conditions. At **Northwest Airlines**, which is still operating in Chapter 11, flight attendants have been seeking court permission to strike. A federal court struck down their suit on Mar. 29, and the union vows to appeal. Airline management says employees are benefiting from the industry updraft. American spokeswoman Susan Gordon notes that employees got 38 million shares of stock when they negotiated givebacks in 2003, a stake now worth more than \$1 billion. United similarly granted nearly 35 million shares of **UAL** stock to more than 64,000 employees, an amount worth \$1.5 billion, when the

company came out of bankruptcy protection last year.

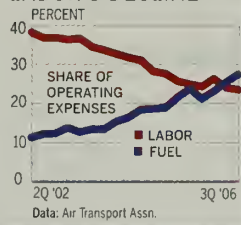
But James Little, head of the **Transport Workers of America**, says such grants were one-time events tied to worker concessions in bleaker

times. Furthermore, airline employees have made huge strides in efficiency. "Because of all the productivity gains, employees should receive some return," he says.

The labor woes come at a still-difficult time for the industry. Although profits are climbing, the major carriers face high fuel costs and continued fierce competition from low-cost carriers. The trick for airline management will be finding a way to reward employees while keeping their companies competitive.

—Christopher Palmeri

LABOR'S DECLINE



65 **PERCENTAGE OF ADVERTISERS** who have produced a **YouTube video to promote their brand**, according to a survey by BusinessWeek.com and the New York American Marketing Assn. The poll was of the 121 top marketers serving as judges for the ad industry's 2007 Effie Awards. To see the full results of the survey, visit www.businessweek.com/go/07/effie.

ECO WATCH



HOW GREEN IS MY COFFEE

WANT AN AVATAR with that latte? Starbucks is serving up an earnest ecology-themed video game at planetgreengame.com, a Web site that was established to burnish the company's environmentalist image. Players create their own avatars, explore the fictional town of Evergreen, and receive grades based on their eco-savvy. Hint: Biking or skateboarding gets you a better score than driving around in an SUV.

Starbucks says the new game was inspired by so-called serious games such as the U.N.'s Food Force. It enlisted **Global Green USA**, a nonprofit environmental outfit, and **Tree Media Group**, a Santa Monica (Calif.) film and Web producer, for writing and creative help. It's promoting the game on its homepage, store receipts, and a sponsored group on Facebook.com. The single product placement is subtle enough: a sound track featuring songs from Starbucks' new employee-produced CD, *Off the Clock*.

—Elizabeth Woyke

WALLY WORLD

IT'S A TOUGH TOWN, NEW YORK

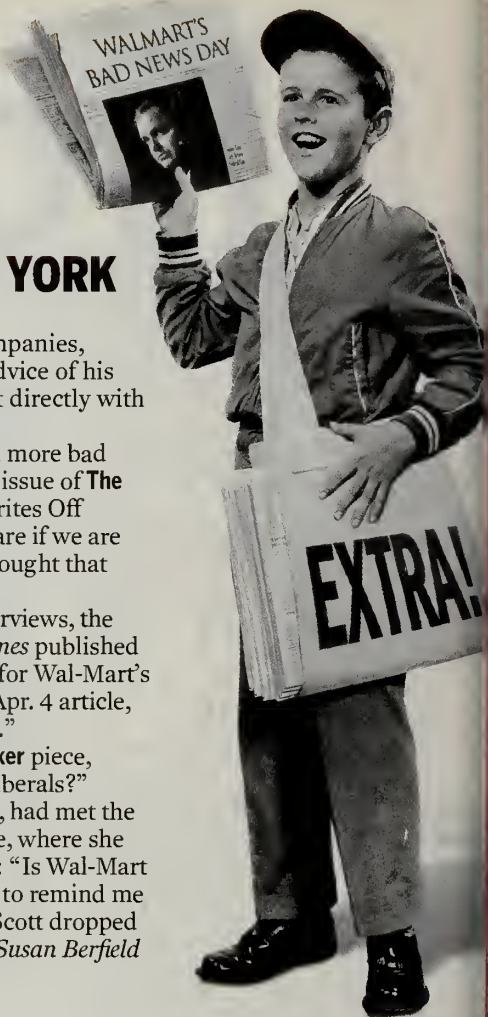
LIKE CHIEF EXECUTIVES of other beleaguered companies, Wal-Mart Stores head H. Lee Scott Jr. took the advice of his public-relations advisers and in late March met directly with some of his critics: the New York media.

But on his goodwill tour he encountered even more bad press. The first story to come out, in the Mar. 28 issue of *The New York Times*, proclaimed: "Wal-Mart Chief Writes Off New York." Scott, who told the paper, "I don't care if we are ever here...I don't think it's worth the effort," brought that misfortune upon himself.

Although Scott was more careful in other interviews, the negative stories continued. The next day, the *Times* published a front-page story, "Bare-Knuckle Enforcement for Wal-Mart's Rules." *The Wall Street Journal* followed with an Apr. 4 article, "Inside Wal-Mart's 'Threat Research' Operation."

On the newsstands, meantime, was a *New Yorker* piece, "Selling Wal-Mart: Can the Company Co-Opt Liberals?" Mona Williams, Wal-Mart's chief spokeswoman, had met the magazine's writer in her Bentonville (Ark.) office, where she has a framed 2003 *BusinessWeek* cover that asks: "Is Wal-Mart Too Powerful?" She told him: "I keep that there to remind me never to trust reporters." Nonetheless, she and Scott dropped by to see us, too.

—Susan Berfield



BEST IN SHOW

GIVING THE BOOTH A BOOST

EVERY INDUSTRY has a trade show—even the folks who put on trade shows. At this year's Exhibitor2007 conference, held at the end of March in Las Vegas, the big pitch was helping companies boost returns on their trade-show investments.

Consultant Martin Smith places cameras over the booths of clients such as **Toshiba** and **Xerox** to monitor traffic flow and the performance of the booth operators. He tells customers not to design booths that have walls, platforms, or sharply contrasting carpet that discourage walk-in traffic.

"A big mistake people

make is treating this like a one-on-one sales call," says Matthew Hill, who trains corporate salespeople. He tells them to invite others into a conversation, so they can pitch two or more potential customers at once.

A rising number of the 13,100 shows in the U.S. have turned to independent firms to audit their attendance. Skip Cox, president of **Exhibit Surveys**, analyzes such data. For instance, if most visitors

are first-timers, he says, a company might not need to build a new booth.

Even providers of "booth babes" are getting into the act. Drae Collins, founder of **GoodGirl Promotions**, says she now puts her spokesmodels through three days of training on client products before hitting the show floor. "They're not only eye candy, she says. "They also write orders."

Trade show attendance in the U.S. peaked at 5.1 million visitors in 1996, according to *TradeshowWeek*. Many have folded or shrunk, as companies shift marketing to online and private events. The 19-year-old trade show for trade shows must be doing something right: Exhibitor2007 drew a record 7,200 attendees.

—Christopher Palmer



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OH, MAN A new cottage industry

TAX HAVENS THE ISLE OF E-BUSINESS

THE ISLE OF MAN, a tax-friendly dot in the Irish Sea, has long been a magnet for well-heeled performers such as actor John Rhys-Davies (*The Lord of the Rings*) and the Bee Gees' Robin Gibb. Now it's chasing another segment of the entertainment industry: film and music download businesses. The local government began its push last April after cutting its corporate tax rates to zero for businesses that move their headquarters to the island and capping personal tax liability at about \$197,000

a year. Since then the island has attracted businesses numbering "well into double figures," says Tim Craine, director of e-business and space commerce for the **Isle of Man Treasury**. **Continent 8 Technologies** CEO Michael Tobin, who launched a business building and operating Internet data centers on the island last year, also cites the locale's strong technological infrastructure, such as its "good connectivity," as a primary selling point for new businesses. But there are other isles in the sea. The Channel Islands Guernsey and Jersey are mulling similar business-friendly tax breaks. —*Lindsey Gerdes*

WEB WATCH CALLING IN THE VIRTUAL G-MEN



THE SEEDIER SIDE of Second Life—the online world where users spend real money to shop as well as gamble and misbehave—is coming under federal scrutiny. **Linden Lab**, the company behind the virtual world, recently invited the FBI to visit its online casinos and clear up what's allowed under last year's

Internet gambling bill. On Second Life, residents bet with Linden dollars, which are not real currency, Linden Lab argues. But virtual profits can be converted to hard cash, through PayPal. Is it offshore gambling? Depends on the scale. "The FBI needs to distinguish the professional gamblers from casual gamblers in Second Life," says Edward Castronova, a telecom prof at Indiana University and a virtual-economy expert. —*Aili McConnon*

OLYMPIC CONTENDERS

Let The Bids Begin

AND THE WINNER IS... Come Apr. 14, the U.S. Olympic Committee will pick either Los Angeles or Chicago as America's nominee to host the 2016 summer games. At stake is economic impact estimated at \$6.5 billion, and the glory of being, however fleetingly, the center of world athletics. The U.S. medalist still must beat a half-dozen foreign cities to claim the title.



CHICAGO

LOS ANGELES

Chief Cheerleader



Patrick Ryan, 69, chairman of Aon, part-owner of the Chicago Bears, and pal of Mayor Daley.

David Simon, 57, lieutenant to Peter Ueberroth when he staged L.A.'s '84 Olympics.



Fund-Raising Goal

\$20 million from private sources, plus \$320 million for a 95,000-seat stadium and at least \$1 billion for an Olympic Village.

\$1 million up front from private sources, and about \$20 million later; \$60 million pledged to enlarge the Home Depot Center.

Local Deep Pockets

Boeing, Sears, McDonald's, and dozens more biggies.

A shorter list topped by Wal Disney, Hilton Hotels, and Mattel.

Inside Track

Pros: The private sector has dug deep before, giving \$200 million for downtown's Millennium Park. Chicago would be a new venue, too.
Cons: No facility is big enough to be a centerpiece. And no celebrity set.

Pros: Sunshine, proximity to Hollywood, good existing facilities, including Los Angeles Memorial Coliseum built for the 1932 Games.
Cons: Has already had its turn, having hosted the Games in 1932 and 1984.

Gaming the Odds

Why Chicago will beat L.A.: "The level of private philanthropy in Chicago has been staggering," says Ryan.

Why L.A. will beat Chicago: "We're asked...not to say anything negative about our competition," says Simon.

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CORNER OFFICE

Jumping Without A Parachute

THE MAR. 31 departure of Steven Heyer from **Starwood Hotels & Resorts Worldwide** is raising plenty of eyebrows. Investors have watched a string of departing CEOs collect fat payouts—even top execs who led their companies' share prices downhill. On Heyer's watch, Starwood's stock marched upward, and he is credited with a number of moves to diversify the owner of such hotel chains as **Sheraton**, **Westin**, and **Le Méridien** and position the \$6 billion company for future growth. Yet he's leaving without a penny in severance. What gives?

The answer may be that directors are finally getting the message: The corporation is not a piggy bank to be plundered for payoffs. Exiting executives get what their contract calls

for, nothing more.

Three years ago, Heyer walked away from the No. 2 position at **Coca-Cola** after directors there wouldn't promise him he could have the top job. After some hesitation, according to published reports, Coke's

board decided that Heyer was departing for "good reason," a common provision in employment contracts that triggers severance payments. Heyer's \$23 million going-

away present was one of several at Coke that drew criticism and ultimately led the beverage giant to change its exit-payment practices.

Did Heyer do something bad to lose out on severance at Starwood? A for-cause firing under his September, 2004, contract would have denied him severance, but "cause" is defined



TIMES SQUARE
Starwood's W Hotel

specifically as such things as felony convictions and gross negligence. A Starwood spokeswoman says that Heyer "was not terminated for cause." Instead, he "resigned," she says, adding: "Steve and the board mutually agreed to the terms of the separation."

It is no secret that Heyer and the board clashed frequently over everything from strategy to his management style. Heyer's decision to base himself in Atlanta and commute to Starwood's White Plains (N.Y.) headquarters on a company jet, for example, was a sore point. From Heyer's vantage point, he too often had to fight to get the board to sign off on his plans. Heyer could not be reached for comment.

Until fairly recent times, even an acrimonious parting of the ways might have led a board to stretch to find "good reason" for the executive's departure and grease the exit slide with severance cash. Not anymore, says James Kim, a compensation consultant at **Frederic W. Cook** in San Francisco. With intense scrutiny of executive pay, he says, "boards are very reluctant to go beyond anything that wasn't specifically negotiated" in contract. Now, he says, they "are going to try to part with as little as possible. The days of trying to do the guy a favor are pretty much gone." —Michael O...



HEYER

QUESTION OF THE WEEK

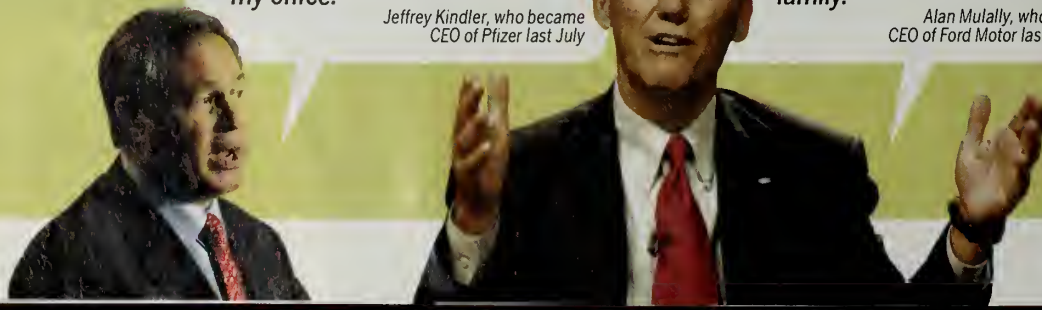
You finally made it to the top. What's the first thing you did when you moved into the chief executive suite?

"I promptly agreed to meet with everyone who has Outlook calendar capabilities—most of the free world, it seemed—but more to the point, I ate lunch in the cafeteria with employees and met with people in their offices instead of having them come to my office."

Jeffrey Kindler, who became CEO of Pfizer last July

"I always keep a camera around. So I had someone take my picture against one window where you could see GM headquarters in the distance, and out another window where Chrysler's headquarters is in the distance. And then I e-mailed them to my family."

Alan Mulally, who became CEO of Ford Motor last October





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“The only really meaningful actions are to reduce one’s own emissions....”

—Anja Kolmuss
 Tufts Climate Initiative
 Medford, Mass.



CARBON OFFSETS: USEFUL TOOL OR SMOKE AND MIRRORS?

AS A NONPROFIT that has pioneered the U.S. offset market for 10 years, ever since Oregon passed the first law requiring new power plants to offset part of their emissions, the Climate Trust agrees that some of the greenhouse gas offsets being sold in the U.S. market are of dubious quality (“Another inconvenient truth,” The Environment, Mar. 26). We also agree that offsets, if done right, can be an important tool for fighting climate change.

The promise of an offset is that, from the atmosphere’s perspective, the results are essentially the same as they would be if a business met its reduction goal by cutting emissions at its own facilities. High-quality offsets allow society to maximize emissions reductions achieved per dollar spent.

We are concerned, however, that the low-quality offsets being offered by some could cause policymakers to throw out the baby with the bathwater.

The Climate Trust provides a model for how to do offsets right. If the rest of the voluntary offset market applied the quality standards developed by the Climate Trust, consumers would get what they pay for, regulators would have greater

confidence in offsets, and, most important, the atmosphere would see a significant increase in environmental benefits.

—Mike Burne
 The Climate Trust
 Portland, Or

CONGRATULATIONS ON exposing the sham marketing of carbon offset credits to assuage the guilt of the rich and famous. Let’s see how far we can carry the hypocrisy of purchasing credits from businesses that would have cut their emissions anyway, either through regulatory mandate or because it made good business sense.

According to People for the Ethical Treatment of Animals, the meat industry is one of the largest contributors to greenhouse gas emissions. Shouldn’t the nation’s millions of vegetarians be receiving carbon offset credits also?

—Jeffrey Lawton
 Tigard, Or

AL GORE AND the organizers of the Academy Awards deserve credit for raising America’s awareness of climate change—and making animal-welfare management seem cool—regardless of whether the carbon offsets purchased for the gift baskets at the Academy

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BusinessWeek
 APRIL 16, 2007 (ISSN 0007-7135) *** 4030
 Published weekly, except for one week in January, July and August by The McGraw-Hill Companies, Inc. **FOUNDER:** James H. McGraw (1860-1948).
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Awards are "additional" or "business as usual." More to the point is that by limiting itself to voluntary efforts, the U.S. is being left behind in the \$20 billion-plus global carbon market.

If *BusinessWeek* focused on the bigger picture, such as Europe's unilateral commitment to reducing emissions and congressional testimony by Al Gore, Sir Nicholas Stern, and the CEOs of major multinationals endorsing a cap on U.S. greenhouse gas emissions, it could help promote a dialogue leading to meaningful action by the U.S. on climate change.

—Veronique Bishop
McLean, Va.

AS ONE OF your sources, I was pleased to read the article on carbon offsets. But there are two things I would like to clarify: The Tufts Climate Initiative is not an advocacy group but a branch of the Tufts Sustainability Office, which helps Tufts University reach its goal of lowering its own greenhouse gas emissions. We conduct research on energy and climate change and help the university implement energy-efficiency projects to cut its carbon footprint.

The Tufts Climate Initiative is not

strictly opposed to carbon offsets. Carbon offsets do have a place in spurring innovation and helping the U.S. move toward a low-carbon economy. However, the only really meaningful actions are to reduce one's own emissions and to be politically active to make sure meaningful legislation is enacted.

To claim climate neutrality simply by buying offsets is, in my opinion, dishonest and misleading.

—Anja Kollmuss
Tufts Climate Initiative
Medford, Mass.

YOUR PIECE PROVIDES a perfect microcosm of the liberal Establishment. Rather than do any heavy lifting to achieve the results they seek, they throw money (someone else's if possible), climb on the shoulders of those who did the work, and crow about the great things they've done.

—Brett A. Larsen
Indianapolis

INDIAN GAMING: THE GOOD AND THE UNFAIR

"PARLAYING CASINOS into empires" (Finance, Mar. 26) appears to suffer from interest-group capture. Both Wall Street

CORRECTIONS & CLARIFICATIONS

"Hail to CVS/Caremark" (Inside Wall Street Apr. 9) should have said that William Dreher is an analyst at Deutsche Bank, not UBS.

and *BusinessWeek* should be applauding the economic development that Indian gaming brings to Indian country.

For generations our people suffered poverty and deprivation while the federal government built infrastructure for other communities just across the river or over the mountains. You could always tell when you got to an Indian reservation because the roads were so bad.

Today, Indian gaming is a catalyst for the economic development of Indian lands and, more recently, of the U.S. economy as a whole. And Indian tribes generally have good, solid relationships with local communities. So your article's discussion of a backlash on Main Street does not reflect the reality of the situation.

—Ernest L. Stevens
National Indian Gaming Association
Washington, D.C.

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Kilburn Castle on the aptly named Lough Awe.

OUR STORY ON INDIAN gaming was reaching to the choir here in Washington State. With 26 federally recognized tribes, some with multiple casinos, as neighbors, Washingtonians are acutely aware of the concerns you discuss.

While pointing out the disadvantages of local nontribal communities, the article did not mention a glaring economic reality: Choosing to continue as wards of the government means that these very successful tribes are still ladling from the finite pot of federal aid that could be better spent accelerating the development of truly destitute tribes in remote locations.

Meanwhile, in order to accelerate the economic growth of local tribes, our state government does not require them to pay any gaming revenue tax. So we state taxpayers just tighten our belts, take up the tax slack, and dream of retiring to Connecticut.

—Michael Whitehead
Marysville, Wash.

WAKE UP AND TAKE THE BUSINESSWEEK 50

AS A RETIRED Dun & Bradstreet employee, I found "The *BusinessWeek* 50" Cover Story, Mar. 26) particularly in-

teresting. Prior to being spun off, Cognizant (No. 12), IMS Health (No. 25), and Moody's (No. 29) were part of the then-\$5 billion-plus Dun & Bradstreet Corp.

Previously shackled by senior management, these companies subsequently flourished. I found this to be a noteworthy comment on the business skills of the people in senior management positions at Dun & Bradstreet at that time.

—Doug Greene
Cortez, Colo.

MORE EVIDENCE THAT YOUR DOCTOR'S OPINION ISN'T GOSPEL

THANK YOU FOR your excellent review of Dr. Jerome Groopman's *How Doctors Think* ("The doctor is in a rut," Books, Mar. 26). Unfortunately, however, by saying that celiac disease is rare, you have committed one of the errors Groopman warns about. Celiac disease occurs in the U.S. in about 1% of the population. That makes it, according to many researchers in this area, the most common hereditary disease among humans.

Ann Dodge's story is a common one in the celiac community. My brother died of lymphoma two years after I was diagnosed with celiac disease. He was

refused testing for celiac disease following the diagnosis of his lymphoma. He was told that celiac disease is rare, that the gluten-free diet is nutritionally inadequate, and that testing for celiac disease might cause his lymphoma to spread. All three of these claims are ludicrous, yet they came from his primary-care physician, someone my brother trusted.

—Ron Hoggan
Calgary

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Waiting for Windows Micro

Since you can buy compact notebook computers weighing less than three pounds for around \$1,200, do we really need teensy, sub-two-pound Windows PCs for \$2,000? I have tried out many ultracompact PCs over the past decade, and none has been truly compelling. The new FlipStart is the best one I've used, but it needs better software to reach its potential.

While no micro-PC has ever been a huge hit, the market is surprisingly crowded. Samsung has its slate-like Q1. Startup oQo has a model called the oQo 2 with a slide-out keyboard. Sony has the Vaio UX1XN, also a slide-out. And this summer a company called HTC will start shipping the Shift, with a flip-up screen.

Vulcan Portals, run by Microsoft co-founder Paul Allen, took a different approach with the FlipStart. It opted for a shrunken version of a conventional clamshell design, just 6 in. by 4½ in., with a 5.6-in. display. The unit crams in all the features of a full-size laptop. Although too small for true touch-typing, the keyboard, unlike most of its competitors, contains all the numbers and symbols in a standard QWERTY layout. For pointing, there is both a touch pad and a track stick.

One feature I greatly admire in the FlipStart is its connect-anywhere wireless. It comes with both Wi-Fi and a modem for Sprint Nextel's high-speed data network (unlimited data for \$60 a month), making it an effective alternative to a BlackBerry or other smartphone. There's even a tiny camera for video-conferencing. It's a bit big to wear on your belt or carry in a pocket, but it can run all Windows (XP or Vista) applications.

FLIPSTART ALSO ADDRESSES another chronic problem of the micro-PC: poor battery life. It does so in the only feasible way, using a really big battery that gives up to six hours of use. The standard extended-life battery, which covers the entire bottom of the unit, accounts for about a third of FlipStart's 1.6-in. thickness and 10 of its 28 ounces. An optional thin battery saves a quarter-inch and 4 oz., but cuts battery life by more than half.

But for all their cleverness, Vulcan Portals' designers failed to solve a fundamental problem. Windows simply

FlipStart's micro-PC is the best yet, but it's tough on the eyes

doesn't work well on a screen much smaller than 12 inches in diagonal, and FlipStart's display is far tinier than that. The screen's high resolution, 1,024-by-600 pixels, is a mixed blessing. Unlike many small displays, you can see, for example, the full width of Web pages without scrolling. But in such a small space, type, icons, buttons, and everything else are minuscule.

FlipStart offers several tricks to get around the difficulty. One is a magnifier button that provides several levels of enlargement for everything on

the screen—at the expense, of course, of showing you less. Another button brings up the FlipStart Navigator, which provides simple access to frequently used programs such as e-mail. And the InfoPane, a 1.8-in. display on the outside of FlipStart's lid, lets you browse e-mail messages, calendar items, and contacts without even opening the unit.

All of these features, however, are essentially Band-Aids. Microsoft, in partnership with Intel, has been aggressively promoting what it calls the ultra-mobile PC as a new class

of personal device. But it hasn't customized its software to suit these radically reduced dimensions. What's needed is a complete reworking of Windows, as well as such key applications as Internet Explorer, Outlook, and Word. This requires hard choices about what has to be on the display. The screens must be simplified—not merely shrunk—for tiny displays to be useful. Until that happens, these mini-PCs will remain tributes to brilliant engineering. But for now it's hard to make a strong case for their use. ■

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Running Tribune—On Empty

So ends Tribune, the publicly traded company. So begins Tribune, the extraordinarily leveraged privately held company. **How leveraged?** The just-announced deal orchestrated by investor Sam Zell leaves the company with more than \$13 billion in debt. To put that in its proper perspective, Tribune's cash flow in '06—earnings before interest, taxes, depreciation,

and amortization, or EBITDA—was \$1.3 billion. Thus its debt exceeds last year's EBITDA by about ten times. This is an angina-inducing multiple even for veteran media players accustomed to playing with debt, some of whom get nervous above six. And Tribune's cash flow comes in large part from big-city Old Media properties, which are not noted for their stability right now. (Tribune's revenues declined by more than 5% in February.) There will be tax benefits to the deal, thanks to Zell's use of an employee stock ownership plan. This also means that said employees take on more risk. Fortunately for them, the deal won't touch previously accrued Tribune pensions, but even so, doubters are not hard to find. "I can hardly wait to share in Tribune's future success through our ESOP," e-mails one sarcastic editor at a Tribune newspaper. (He may have already known that Tribune will stop contributing to employees' 401(k)s.) As for Zell, who isn't discussing the deal: He bought a massive media conglomerate for over \$8 billion by paying \$315 million down. In the mid-'90s, Tribune was one of the newspaper sector's darlings. In 2007, it's a company that dragged through a six-month sale process so patently lacking in any enthusiasm that its deadline had to be extended twice, before being sold to a guy who's nicknamed "Grave Dancer."

WE ARE ABOUT TO SEE how smart Sam Zell is and whether an outsider can better remake an industry suffering through serious challenges. (He's made an enormous fortune as a Chicago real estate investor, which makes him the latest iteration of the old saying that the local newspaper's buyer of last resort is a local developer.) However, Zell will run Tribune with so much debt it's hard to imagine he'll have room to invest even in the most necessary new ventures—like, say, a modernized Web site for the company's single largest asset, the *Los Angeles Times*, which in December was the subject of a lacerating internal review. (A "lack of financial flexibility could make the company lag its better-capitalized peers that might be able to make such investments," says Mike Simonton, a senior director at credit analyst Fitch Ratings;



observers might consider how slowly so better-capitalized industry peers have made these investments.)

The *Times* has failed to perform to Tribune's profit expectations—unrealistic ones, staffers there would say—and it has been rent by a series of conflicts with corporate executives that resulted in the departures of two consecutive top editors and one publisher. This led to the oft-expressed wish among *Times* staffers—sometimes in print—for private ownership and relief from Wall Street's merciless quarterly profit demands. But what Zell

Why is this man laughing? Zell leaves Tribune deep in debt

will need to do just to service the debt may end up making staff nostalgic for public ownership. When asked where Zell may find cost-cutting opportunities, two executives immediately pointed to the *Times* and its 900-plus newsroom employees.

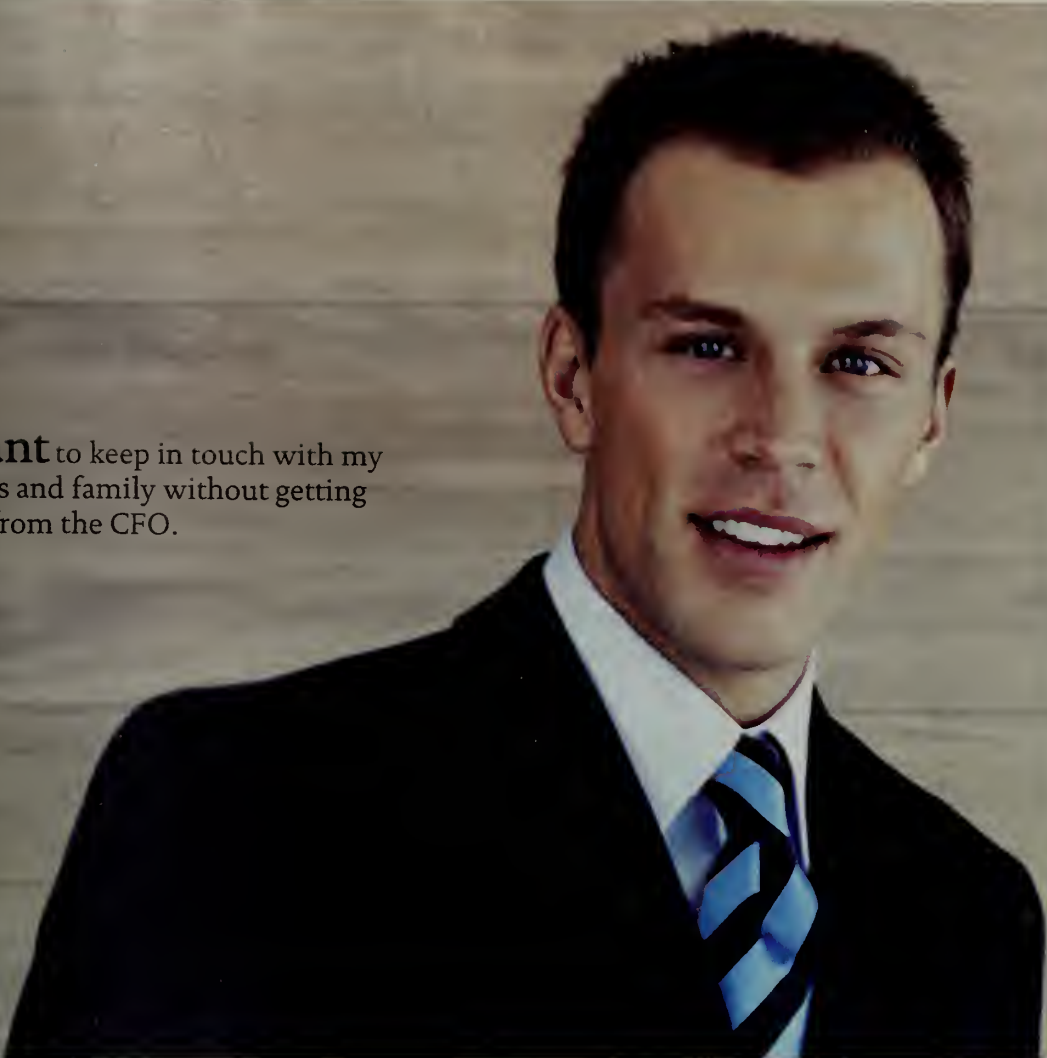
"We think this is a very good result," says John Rogers, chairman and chief executive of Ariel Capital Management, a major Tribune shareholder. "I still believe there is an upside

in newspaper stocks." The market obviously disagrees with him on that last point. Meanwhile, the deal leaves Tribune with massive debt obligations for a premium that ends up being not quite \$2 per share above where the stock closed before negotiations with Zell went into their endgame in March. Should Rogers be right about the stock market, there are many current shareholders who won't make out well in a deal that takes Tribune private. Most notable among them the Chandler family, the prickly, tax-averse faction whose vocal dissent last June started the landslide. ■

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BY JAMES C. COOPER

Earnings Season Is About to Get Chilly

softer economy and sagging margins will sap profits this year

U.S. ECONOMY Corporate profits have been on a tear for more than three years. Defying expectations, earnings growth remained strong last year, completing a record 14 consecutive quarters of double-digit gains from the previous year. Get ready for a change. The profits slowdown already appears to have started, and margins are getting

squeezed. For 2007, the combination of cooler demand and warmer labor costs will create a tough economic climate for earnings. Investors who don't adjust their expectations are bound to face some disappointments as the year progresses.

Some slowdown in earnings seemed inevitable.

Last year's tightening in the labor market kept upward pressure on wage costs at a time when productivity growth was cooling off. That means many companies are less able to offset rising labor costs with gains in efficiency, a sure recipe for slimmer profit margins. Now companies are facing a double blow. Not only will they be earning less on each item they sell, but the economy also is proving to be a bit softer than many economists had anticipated. That means top-line revenue growth will most likely fall short of expectations as well. In addition, last year's strong profit performance set the bar high for year-ago comparisons.

Just ahead of the first-quarter earnings season, which kicks off unofficially on Apr. 10 with Alcoa's report, the estimate for quarterly growth stands at a somber 3.8% in a year ago, according to Thomson Financial. That's sharply below the 8.7% expectation at the beginning of the quarter. The emerging question for the rest of the year: Can earnings growth stay above water?

IT'S GOING TO BE A STRUGGLE. Economists are lowering their forecasts for economic growth after some surprisingly weak reports of late and the tightening of credit conditions resulting from the subprime mortgage meltdown. The housing slump appears to be deeper and more protracted than previously expected, and capital spending by businesses will not provide the support it has been projected to offer. Consumer spending appears to have held up well last quarter, but costlier food and energy will take a toll this quarter (page 26).

Many forecasters have lowered their expectations for first-quarter growth in real gross domestic product to less than 2%, with little better than 2% projected for the second quarter. Numbers like that would only reinforce the latest round of corporate spending caution and imply a further slowing in the growth of jobs and

incomes, adding to the weight on consumer demand.

Corporate profits in last year's fourth quarter were actually weaker than they looked. Compared with the previous year, earnings for the companies in the Standard & Poor's 500-stock index rose nearly 11%, and even higher excluding the energy sector, where profits were depressed by falling prices for oil and gasoline. However, on a sequential, or quarter-to-quarter, basis, earnings declined.

That drop also shows up in the government's more comprehensive roundup of fourth-quarter profits. Overall earnings, adjusted by the Bureau of Economic Analysis for seasonality and some conceptual differences between government definitions and company reporting, fell 1.2% from the third quarter, measured at an annual rate. Profits for nonfinancial corporations fell 24%, the

largest drop in almost four years. Energy companies accounted for more than half of the loss, but wholesale trade, commercial transportation, and other industries also posted big declines.

In addition, profit margins, measured as earnings per unit of output of nonfinancial companies, fell to

MARGINS APPEAR TO HAVE TOPPED OUT



14.2¢, the lowest in a year, from 15.3¢ in the third quarter (chart). And you can't blame that dip solely on the weakness in the energy sector. Unit labor costs, or workers' compensation adjusted for productivity gains, soared at a 6.9% annual rate, more than six times faster than the increase in prices.

THE PRESSURE ON MARGINS will only increase. Given the expected softness in first-quarter growth, productivity appears to have posted another tepid gain, while wages and salaries through February have spiked upward, boosted by big bonus payments and stock option

exercises. Unit labor costs are sure to post another large increase in the first quarter that will once again swamp the rise in prices and squeeze margins further. Based on Treasury Dept. data through Mar. 30, corporate tax receipts in the first quarter are up only 17.7% from a year ago, the slowest pace in 3½ years.

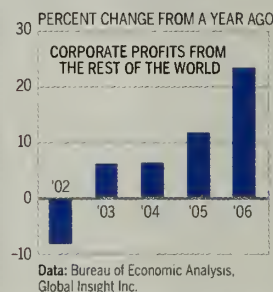
PROFITS THIS YEAR will have a couple of supports to help cushion the impact. One is overseas revenues and earnings. Global economists at UBS calculate that foreign sales of companies in the S&P 500 accounted for 29% of all sales in 2005, up from 25% in 2001. So companies active in foreign markets should fare better than those who aren't. The government's latest accounting shows profits from the rest of the world in the fourth quarter of last year were up 38.5% from a year ago, and they accounted for 16.5% of the earnings of U.S. corporations (chart).

With U.S. exports booming, more gains seem likely. Fourth-quarter shipments, adjusted for inflation, were up 9.4% from a year ago, the strongest showing in more than two years, and the momentum continued into the first quarter. For example, makers of business equipment, while suffering a period of weak capital spending in the U.S., are finding strong demand overseas.

Economies abroad are robust and seem likely to remain so, with growth fueled by solid domestic demand, which will limit the impact of the U.S. slowdown on foreign activity. Growth in Europe has generally beat expectations. Late-year gains in Japan eased fears of a slower recovery there. China is still on a tear, and most emerging-market economies are performing well.

Corporations on the whole are also in a financially sound position with solid balance sheets, which many are using to their advantage. Companies may be hesitant to borrow money for new equipment and other expansion projects, but they have not been shy about using their financial clout to enhance future earnings per share through stock buybacks.

A KEY SOURCE OF EARNINGS GROWTH



They retired, on net, a record \$602 billion in shares last year. Companies this year will still have financial power to support more buybacks, helping to offset some of the huge drag from softer operating earnings.

On Feb. 26, when former Federal Reserve Chairman Alan Greenspan rattled the markets with his recession comments, one of the trends he cited was profits. He noted that margins had begun to stabilize, which is usually a sign the economy is in the late stage of a business cycle.

However, equity investors needn't throw in the towel just yet. It often takes a long time after profits and margins peak before any stress on the corporate sector and the economy takes hold. Consider the late 1990s: Margins peaked in the second half of 1997, but it took three years and the tech bust for the economy to feel it.

CONSUMER SPENDING

Pain at the Pump and the Checkout

CONSUMERS ARE about to face another stress test. Higher energy and food prices are threatening to erode purchasing power and could put a noticeable dent in consumer spending this spring.

Together, food and energy account for more than a quarter of consumer expenditures, which means the recent price gains could leave a lot less money for spending on other goods and services. During the first half of the year, "the combination of surging energy and food [prices] threatens to drain more than \$100 billion of purchasing power," according to Morgan Stanley chief U.S. economist Richard Berner.

Middle- and lower-

income households will feel the biggest squeeze from higher prices. According to the March Reuters/University of Michigan consumer sentiment index, 40% of families with income under \$50,000 say their current financial situation has worsened.

Spending hasn't slowed much yet, but most of the impact is likely to come this quarter.

Indeed, the average price for a gallon of gasoline kicked off the second quarter at \$2.64, the highest level since Labor Day weekend of last year. Meanwhile, the cost of food has also risen noticeably in 2007. The Commodity Research Bureau's index tracking

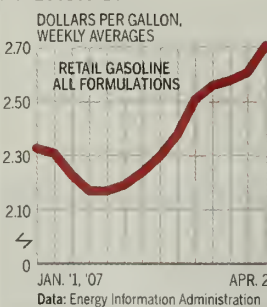
foodstuffs is up 7.7% so far this year.

The rise in gasoline prices goes beyond higher oil prices brought about by Iran's detention of 15 British sailors. Gasoline inventories are falling sharply. What's more, lower oil production by OPEC members and refinery shutdowns have constrained supplies. Overall gasoline prices could move close to a national average of \$3 per gallon, says Berner. The picture for food prices looks a little less threatening on forecasts of a record corn harvest this year.

Right now it appears consumer spending won't collapse. But further upward surprises in energy and food prices could seriously impact spending, since many Americans most affected by higher prices are already feeling stressed out about the housing recession. ■

—By James Mehr

GASOLINE PRICES GO BACK UP



**Our Blueprint
for America
is actually
quite green.**



This year the American Institute of Architects (AIA) is celebrating its 150th anniversary with a nationwide community service initiative, Blueprint for America. AIA architects, donating their time and expertise, are collaborating with citizens to find and implement ways to enhance their communities. Over 150 projects have been funded, tackling issues ranging from environmental sustainability to homelessness to disaster preparedness. For 150 years, members of the AIA have worked to create more valuable, healthy, secure, and sustainable buildings and cityscapes. What better way to celebrate our past than by helping America's communities design better, more sustainable futures? Learn about every Blueprint for America project, and other ways the AIA is celebrating its anniversary in your community, at www.aia150.org.

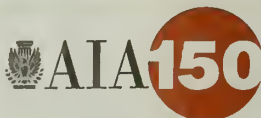
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NEWS YOU NEED TO KNOW EDITED BY HARRY MAURER



SCORE ONE FOR THE GREENS

Environmentalists were cheering after the Apr. 2 **Supreme Court** decision in *Massachusetts v. Environmental Protection Agency*. The justices issued a 5-4 decision rebuking the **Environmental Protection Agency** for failing to act to cut greenhouse gas emissions. "The harms associated with climate change are serious and well recognized," wrote **Justice John Paul Stevens** for the majority, which also ruled that states have legal standing to bring cases alleging damage from such emissions.

The ruling knocks the wheels off carmakers' legal challenge to carbon dioxide tailpipe emissions reductions proposed by California (photo, Los Angeles traffic) and 10 other states. It gives a boost to states' suits against utilities for alleged harm from global warming caused in part by power plant emissions. And it raises the chances of Congress' passing climate change legislation that will affect the entire economy. See "Lighting a fire under global warming," page 33, and **ONLINE** "Court turns up the heat on global warming," www.businessweek.com/go/tbw

The Korean Connection

It's the biggest bilateral free-trade pact ever—and the largest trade deal the U.S. has signed since **NAFTA** in 1994. On Apr. 2 the U.S. and South Korea shook hands on a deal that will open new markets for U.S. farmers and ranchers and will benefit Korean auto and textile manufacturers—if ratified by both legislatures, which is by no means certain. Forecasts by Korean government-funded

institutes show the countries' two-way trade, which topped \$75 billion in 2006, could hit \$90 billion to \$100 billion within a few years. Meanwhile, Washington on Mar. 30 slapped tariffs on imports of glossy paper from China. See "Private equity vs. China," page 30; "Now it's a global stalemate," page 32; and **ONLINE** "Korea trade pact: No easy ride for Detroit," www.businessweek.com/go/tbw

Extra! Extra! Zell Wins!

Real estate maverick **Sam Zell** on Apr. 2 captured **Tribune** with a bid that values the company at \$8.2 billion. See "Running Tribune—on empty," page 24, and **ONLINE** "Zell's big plans for Tribune," www.businessweek.com/go/tbw

Corn Stands Tall

Ethanol thirst. That's what'll bring a bumper 2007 corn crop,

said an **Agriculture Dept.** report on Mar. 30. The forecast—for 90.5 million acres, up from 78 million in 2006—knocked down prices a bit, but they're still high as an elephant's eye thanks to fast-rising demand for ethanol. Farm equipment makers, meat producers, and ethanol brewers will benefit from the corn-ucopia.

ONLINE "Has corn hit its peak?" www.businessweek.com/go/tbw

KKR Strikes Again

Another week, another humongous buyout. Private equity giant **Kohlberg Kravis Roberts** said on Apr. 2 that it will grab electronic commerce and payment services provider **First Data** for \$29 billion. KKR will thus become a power in processing everything from credit cards to debit cards to electronic gift cards to fraud protection.

Apple's Bumpy Day

Good Apple or bad Apple? On Apr. 2, **CEO Steve Jobs** and **EMI Group CEO Eric Nicoli** trumpeted a deal under which songs by EMI artists would be sold on the **iTunes Music Store** without anti-piracy strictures. That means those songs could be copied and played on devices other than the **iPod**. Hours later news broke that the **European Union** had sent an antitrust complaint to Apple and three other companies, asking why the same song on iTunes costs different amounts in different countries.

ONLINE "EMI, Apple remove music's copy locks," and "Apple's international iTunes controversy," www.businessweek.com/go/tbw

The Subprime Mess

It took a while, but **New Century Financial** finally did what everyone on Wall Street had been predicting for weeks:

le onetime darling of the
bprime mortgage biz filed
bankruptcy on Apr. 2 and
id it would lay off 3,200,
ore than half its workforce.
ew Century is the best-
own of more than two dozen
bprime lenders to go bust
get acquired over the past
months. Its stock, trading
ound \$40 last October, had
nk to less than a buck on the
ng date.

LINE "The subprime story's
est chapter: 11"
www.businessweek.com/go/tbw

Shoppers Step It Up

What, consumers worry?
Apparently not: The Commerce
Dept. said on Mar. 30 that
personal incomes and
spending both rose 0.6%
in February, way above
what dismal scientists had
predicted. On the other hand,
inflation seems to be stirring,
with the core personal
consumption expenditures
index up 2.4% from a year ago.
See "Pain at the pump and the
checkout," page 26

Where'd That Money Go?

Releasing only a sliver of
info about a major probe,
FBI on Mar. 29 said an
internal investigation has
identified "errors, evidence of
misconduct, and deficiencies

in the financial control
environment." It wouldn't
elaborate. The PC giant, whose
accounting the SEC and the
U.S. Attorney for the Southern
District of New York are also
studying, said it'll hold off
filing its yearend report beyond
the extended Apr. 18 deadline.
The stock barely budged.

ONLINE "Dell: Prolonging the
agony,"
www.businessweek.com/go/tbw

Stuck in Reverse

More of the same from the
Big Three carmakers, who
announced March U.S. sales
on Apr. 3: **General Motors**,
down 7.5%; **Ford**, down 13.5%;
DaimlerChrysler, down 7.4%.
The numbers should keep
shrinking all year as Detroit
pares back. **Toyota**, meanwhile,
revved up by 7.4%. On Apr. 4,
DaimlerChrysler confirmed it's
trying to offload Chrysler.

ONLINE "Detroit's growing green
problem,"
www.businessweek.com/go/tbw

Vacancy at Starwood

CEO Steve Heyer and Starwood
Hotels & Resorts parted ways on
Mar. 31. The stock jumped 9%
by Apr. 4, partly on speculation
that the company might put
itself in play.

See "Jumping without a
parachute," page 16

CAPTURED FUGITIVE OF THE WEEK

Online gambling king **Gary Kaplan** has been on the lam since
being indicted by a federal grand jury in June—but no longer.
The law caught up with the **BetOnSports** founder on Mar. 28 in
the Dominican Republic, where he was arrested and sent to
Puerto Rico to await extradition to the U.S.
on wire fraud charges. But even as federal
prosecutors continued their long-running
crackdown on Internet betting operators,
the **World Trade Organization** slammed the
U.S. on Mar. 30 for thumbing its nose
at a 2005 ruling that America's online
betting ban violates global trade rules.
Despite its big win, **Antigua**, the \$1 billion
micro-economy that houses many online
gaming operations and that brought the
trade complaint, doesn't plan to impose
retaliatory sanctions because U.S. exports to Antigua are so
tiny that Uncle Sam wouldn't even feel a pinprick. "It's a huge
problem," admits **Mark Mendel**, Antigua's lawyer. Instead, the
Caribbean nation is pushing Washington for the right to do
business with U.S. bettors and has invited American regulators
to help keep its gambling industry on the up-and-up.



GARY KAPLAN

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Broadband market coverage as of 3/15/07. Not available in all markets/retail locations. Free Card
Offer: Subject to credit approval. Additional restrictions apply. Mail-in Rebate: Requires purchase
by 6/17/07 and activation by 7/1/07 of new line on Unlimited Data Plan (\$59.99) and two-year
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IT'S HARD TO THINK OF AN AMERICAN product that's less strategically important than the coated paper that magazines, annual reports, catalogs, and auto-dealer brochures are printed on. Yet there was Commerce Secretary Carlos M. Gutierrez, on Mar. 30, announcing tariffs on coated-paper imports from China—the first time in at least two decades that U.S. ant subsidy law has been applied to that country. By acting against unfair China trade, he said, the U.S. was standing up for “American manufacturers, workers, and farmers.”

But Gutierrez left out one important group of beneficiaries: private equity investors. It turns out the paper manufacturer that brought the complaint, NewPage Corp., is owned, through several levels of intermediaries, by New York-based Cerberus Capital Management, the mammoth private investment group controlled by the wealthy and reclusive Stephen A. Feinberg. Another big industry player, Verso Paper, is majority-owned by affiliates of private investment firm Apollo Management.

The government action raises obvious questions about the political influence of private investment firms, especially since the chairman of Cerberus, John W. Snow, served as President George W. Bush's Treasury Secretary from February, 2003, to July, 2006. But Cerberus says Snow didn't make phone calls on NewPage's behalf. And Cerberus has investment interests far beyond coated paper—Snow recently toured China calling for closer business cooperation between that country and the U.S.

But in a broader sense, what's going on is nothing less than a showdown between two very different ways of financing business. On the one side is China, which is accused of lowering the capital costs of coated-paper makers through subsidies such as low-cost loans and debt forgiveness. On the other side are the private money outfits, which raise huge funding pools by promising investors high returns in a low-return world.

The trade sanctions—which the Commerce Dept. could still back away from—would protect private equity-owned paper mills from China's cheap capital and help private investors realize the high returns they want. This battle of financial systems may be a harbinger of

TRADE

PRIVATE EQUITY

How the Commerce Dept. crackdown on Chinese paper exports will help Cerberus Capital and friends.

BY PETER COY AND MICHAEL MANDEL



WITTY VS. CHINA



the next wave of trade disagreements.

How did we get into this situation? Over the past couple of years, U.S. paper giants such as MeadWestvaco Corp. and International Paper Co. wanted to shed some of their lagging divisions. They found ready buyers in the private equity firms, which saw a good deal.

In particular, in early 2005, MeadWestvaco sold its coated-paper mills and other assets to NewPage for \$2.1 billion. The newly formed company took on about \$1.8 billion in debt to finance the purchase. A Cerberus-owned affiliate tossed in \$415 million in equity, according to documents filed with the Securities & Exchange Commission. (Disclosure: The same documents list The McGraw-Hill Companies Inc., the parent company of *BusinessWeek*, as one of NewPage's biggest customers.)

CHINESE LOCOMOTIVE

THIS LEVERAGED BUYOUT left NewPage with big debts and hefty interest payments totaling \$165 million in 2006, roughly double the size of its \$88 million in capital expenditures. Such heavy debt makes it harder for the company to compete against the Chinese, as well as big European paper manufacturers. NewPage filed the complaint against the Chinese in October, 2006, about 18 months after Cerberus took over. This was the first time since 1991 that any company had formally filed such a complaint against a nonmarket economy.

Now, the fact that NewPage is owned by a private investment firm doesn't make the trade sanctions wrong. Indeed, the big paper makers may have sold off their businesses in part because they saw the onrushing Chinese locomotive of cheap coated paper exports, which have soared from \$21 million in 2004 to \$224 million in 2006. The trade sanctions, if they stick, could help preserve the more than 4,000 jobs at NewPage, many in economically depressed areas of the U.S.

And it can be argued that China is at the point where such subsidies are unacceptable, just as capital subsidies to Airbus and Boeing Co. are unacceptable for Europe and the U.S. "Our view is very simple," says Mark A. Suwyn, NewPage CEO. "We will compete with anybody in the world if it's fair. China can't join the WTO and then choose to use my country as a dumping ground. That's illegal."

A lot of people who worry about the rising tide of Chinese imports agree with Suwyn. But would they want to start a trade war with China to protect private equity investors? ■

Now It's a Worldwide Stalemate

Negotiating for freer trade among nations is like riding a bicycle into a strong headwind. You're O.K. as long as you keep moving forward, but if you slow down too much you're in danger of tipping over. Right now the world's free-trade bicycle looks wobbly.

The latest bad news for free-trade advocates was the U.S. announcement on Mar. 30 of tariffs on coated-paper imports from China and the signal that more tariffs could be in the offing. China said it "strongly urges the U.S. side to reconsider the

lately, even though the U.S. trade deficit excluding petroleum has been shrinking lately as a share of the economy. "It's a critical juncture," says Philip I. Levy, a resident scholar at the pro-free-trade American Enterprise Institute.

Progress is still possible. President George W. Bush would love to bring the Doha Round to a successful conclusion before leaving office. And some key senior Democrats, including House Ways & Means Committee Chairman Charles B. Rangel (D-N.Y.), are genuinely committed to the cause of free trade and may be able to bring along



Even the new trade accord with South Korea restricts U.S. beef imports

decision and reverse it as soon as possible." The Doha Round of global trade talks, launched in 2001, was suspended last July, and there's no timetable for a relaunch. Even the heralded free-trade agreement with South Korea, reached on Apr. 1, is a compromise that opens sales of American cars and TV shows but still shields Korean farmers from American rice and beef. U.S. pickup trucks are protected, too. If it's rejected by lawmakers in either country—a real possibility—the attempt at a deal could actually worsen U.S.-Korea trade relations.

Think of this as a contest between two powerful forces: globalization vs. the backlash against it. Openness to imports and exports helps consumers by lowering prices, stimulating innovation, and increasing the variety of goods and services for sale. But it also wipes out some jobs, and that visible downside has been getting most of the attention

some of the doubters.

If the U.S. manages to ink free-trade agreements with Korea as well as Colombia, Panama, and Peru, it could get some momentum going that might carry over to a restart of the stalled Doha Round. New energy from the U.S. might put pressure on other parties whose recalcitrance has contributed to the global stalemate, from French dairy farmers to Brazilian automakers.

Trouble is, Bush is fighting an unpopular war in Iraq and facing a Democratic Congress at the start of a Presidential campaign. And even an ambitious trade agreement would have no impact on the most important factors behind the huge global trade imbalances—namely, excessive saving in China and undersaving in the U.S. No wonder that bike is wobbling. ■

—By Peter Coy



THE SUPREME COURT

LIGHTING A FIRE UNDER GLOBAL WARMING

A key ruling empowers environmentalists—and turns up the heat on business

BY JOHN CAREY

THE FIRST FALLOUT from the U.S. Supreme Court's dramatic 5-4 decision on global warming came swiftly. Just two days later, on Apr. 4, lawyers gathered in a Vermont courtroom. The Green Mountain State, one of 10 states that have adopted California's proposed limits on carbon dioxide emissions from vehicles, had been sued by automakers seeking to block the rules. At the Vermont hearing, environmental lawyers argued that Detroit no longer had much of a case—and the state now is expected to win. "The Supreme Court knocked the legs out from under all of the claims of the carmakers," says Natural Resources Defense Council attorney David Doniger. The Supreme Court's decision is slipping through other courtrooms, statehouses, and even boardrooms across the nation. Even if, as most expect, the Environmental Protection Agency and White House do not use their court-sanctioned authority to force greenhouse gas emission cuts, the ruling sweeps away much of the legal challenge

to the auto regulations in California and the other states, which will force automakers to improve fuel economy. It also gives a boost to state suits against utilities for alleged harm from power plant emissions. "Since November, this issue has accelerated from 5 mph to 80 mph," says Peter A. Molinaro, director of government affairs at Dow Chemical Co. The ruling "just adds more momentum."

The heart of the high court's ruling is that carbon dioxide is a "pollutant" under the Clean Air Act and thus can be regulated by the EPA. Equally important,

Justice John Paul Stevens dismissed the claim that Massachusetts and other states had no legal standing to bring the case because they hadn't suffered injuries from global warming. "The harms are associated with climate change are serious and well-recognized," he wrote.

ONE FEDERAL RULE

IN MAKING THE decision on standing, the court ruling removed a roadblock for key suits in federal courts. "It's hard to overstate its importance in the litigation arena," says J. Kevin Healy, a partner with law firm Bryan Cave. It improves the chances of existing lawsuits, like one led by Connecticut asking utilities to lower their emissions. And it could bring what Arnold & Porter partner Michael B. Gerrard calls a "forest fire of litigation" against business, which has been working hard to get the issue out of the courts.

The door now is open for new lawsuits against companies that emit carbon dioxide. However, the suits have always been a means to an end, a way to pressure companies into supporting mandatory national emissions limits. "Ultimately, the litigation is aimed at Congress and the White House," says Gerrard.

It's working. U.S. carmakers and their biggest supporter, Representative John D. Dingell (D-Mich.), had long opposed boosting fuel economy standards. Now they have signed on to federal legislation. They'd rather have one national rule than the patchwork of state regulations. The justices' decision "provides another compelling reason why Congress must enact, and the President must sign, comprehensive climate change legislation," Dingell said in a statement.

Other groups and companies that once opposed mandatory carbon curbs, like the utility industry's Edison Electric Institute and Dow Chemical Co., have come to the table, too. Healy tells his corporate clients they can't ignore global warming any longer. "They have to think about it when planning for the future," he says.

In the wake of the Supreme Court decision and increasing international concern (page 90), there's even more pressure for national legislation. If Congress and the Bush White House cannot reach an agreement, business fears that the next Administration might impose tougher rules than the bills now under consideration. The top Presidential candidates from both parties have endorsed policies to limit carbon emissions. ■

Courting Change

The justices' 5-4 decision on carbon dioxide raises the stakes for industry

LIKELY RESULTS

AUTOMAKERS will face higher state or federal fuel economy standards.

CONGRESS is more likely to pass laws limiting greenhouse gas emissions.

STATES alleging harm from global warming get a lift in cases against polluters.

CONSEQUENCES

Hits Detroit harder than rivals such as Honda or Toyota.

Biofuels, renewables, and nukes gain. Gasoline and coal power prices will rise.

Industry backs carbon-cutting plans in Congress to preempt state action.

COMMENTARY

BY DIANE BRADY

A Little Shame Goes a Long Way

Why Catalyst should go back to naming companies without women at the top

THERE WAS A TIME when corporate titans were right to be nervous about Catalyst. The pioneering women's research organization, which opened its doors in 1962 (a year before Betty Friedan published *The Feminine Mystique*), has long been regarded as a powerhouse in tracking and promoting the advancement of executive women. Its

annual awards, now in their 20th year, confer star status on companies for doing groundbreaking work. Its research reports have been pointed and precise about what was holding women back, often giving data that allowed everyone to see which companies operate as men's clubs.

But that was last year. When Catalyst released its 2006 census of women at America's 500 largest companies a few weeks ago, a breakdown by company was missing. Instead, a short report on the group's Web site noted that women were "losing ground" and "dramatically underrepresented at the high-

est levels of business." The percentage in corporate officer and director positions fell, to 15.6% and 14.6%, respectively, from 16.4% and 14.7%.

Don't look to Catalyst to help spot the worst offender. President Ilene H. Lang says it takes too much time and there's little value to publishing the data by company. "We're not in the shame game," she says. "We don't find that public embarrassing people achieves anything." It certainly used to. The day before Jeffrey R. Immelt became chairman of General Electric Co. in 2001, he told *BusinessWeek* that he'd cringed at a photo in *The New York Times* showing no women among GE's

top 31 officers: "It haunted all of us." Immelt consulted with Catalyst, got more women into the senior ranks, and, in 2004, won a Catalyst Award.

That Lang insists nobody cares about such specific information—"except for a couple of people in the press"—may say much about the mindset in today's corporate suites. Some talk about "diversity fatigue." Gender pales next to hot-button issues like going green or expanding in China. Lang says it's still a priority for the member companies that fund its \$11 million annual budget, including \$1 million in advisory fees.

Who are those members? More than 340 multinational companies, including Amgen, Dell, FedEx, and Whirlpool, all four of which have no women among their top-paid corporate officers. The membership list also includes recent Catalyst Award winners like Safeway, BP, and Chubb. Each pays \$10,000 to \$100,000 or more annually, in part to associate themselves with the Catalyst name. Says Lang, "We're a corporate membership organization that's here to serve our members."

• 'TOUGH QUESTIONS'

CATALYST'S reputation was built on being more than a diversity consulting service. Lang takes pride in "asking tough questions." Julie Hembro Daum, a former Catalyst executive now at search firm Spencer Stuart, says "there's no other organization out there that has the brand name, the access, and the credibility



INCENTIVES
Lang prefers to cite model companies

Men's Club

Catalyst has stopped running data that reveal the number of top female officers at individual companies. Here are some prominent companies with no women among their top five corporate officers.

AMGEN	DIRECTV
BALL	DOW CHEMICAL
BEAR STEARNS	ECHOSTAR
BEAZER HOMES	FEDEX
BORDERS	GATEWAY
BRINK'S	PROGRESSIVE
CIT GROUP	SAKS
DANAHER	STRYKER
DELL	WHIRLPOOL

Data: Company proxy statements; BusinessWeek

ake on this issue." But, adds Toni G. Volfman of Bentley College Women's Leadership Institute, "Catalyst has to earn its reputation.... Somebody has to keep the pressure on, and disclosure is part of the solution."

Lang believes the best way to promote women is to reward companies that do so. Catalyst honors efforts through annual awards; four were handed out this year to Goldman Sachs, PepsiCo, PricewaterhouseCoopers, and Citibank. The chief executive of each company came to New York's Waldorf-Astoria on Mar. 21 to pick up the honor, while more than 60 peers and 1,600 others looked on.

After so many years of giving multiple awards, it's worth asking if it's getting more difficult for Catalyst to find groundbreaking work. Lang says the bar just gets higher.

If dozens of companies have done so much, though, why do so few have women at the top? It's not like women haven't been flooding into law schools and MBA programs for decades. And Catalyst has been drawing record crowds at its events.

**meone
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, "says
e critic**

But it's hard for a company to look cutting-edge with a corporate lineup that evokes the 1950s. Newell Rubbermaid Inc., which sells such staples as Goody hair products and Graco baby goods, has a 13-member leadership team composed of white men. That lack of diversity was clear in Catalyst's 2005 Census. Last year, it named two senior-level women to lead diversity and organizational development programs. "We're taking action to ensure that our employee base better reflects our diverse consumer base," says spokesman David Doolittle.

Would Newell Rubbermaid have bothered if nobody had highlighted the dearth of women at the top? Maybe. Lang notes that Catalyst is about to post a list of the 58 companies with no female directors. As for the tougher job of advancing women into the top ranks, she says, "there's a lot of power looking at the overall numbers." Here. But former Catalyst President Sheila Wellington points out that when it comes to looking for top women at each company, "there's a lot of power in the word 'none.'" ■



THE SUBPRIME MESS

HOW BIG IS THE BITE ON FANNIE AND FREDDIE?

The mortgage giants' exposure to risky loans could be bigger than they say

BY DAWN KOPECKI

COULD THE SUBPRIME mortgage flu spread to Freddie Mac and Fannie Mae? These giant financial companies, which keep the mortgage market liquid by buying loans from banks and selling them to investors, are also heavily invested in subprime. In fact, they're the biggest buyers of securities backed by loans to risky borrowers. Freddie says it owns \$124 billion, while Fannie reports \$56 billion.

Some analysts suggest the two may even be underplaying their exposure. Part of the problem is that definitions of subprime can differ. The biggest quibble is over Freddie and Fannie's investments in securities created from pools of mortgages not issued or guaranteed by the two agencies. These so-called private-label loans total some \$235 billion and \$114 billion, respectively, for Freddie and Fannie. The companies include roughly half of that category in their subprime totals. But Paul Miller, an equity analyst at Friedman Billings Ramsey, says they should include more: "Subprime is in the eye of the beholder."

Taking a step back, industry-wide data show subprime and other risky loans account for the bulk of private-label issues. According to data tracker

Inside Mortgage Finance, 74% of the \$1.15 trillion private-label, mortgage-backed securities issued last year were not considered regular or "prime."

Still, in either calculation, subprime is only a small piece of their overall business. Freddie's total portfolio tops \$2.2 trillion; Fannie's, \$2.6 trillion. Both also mitigate their risk by primarily owning the highest-rated securities in the subprime group and then adding credit enhancements, extra insurance against potential losses. "The nature and scale of our participation in the subprime market should insulate us from material losses," Fannie chief executive Daniel Mudd said in a February conference call. "Having [a lot of] size doesn't mean having [a lot of] risk," says Freddie financial chief Anthony Pizel. Even Miller admits they own the "safest pieces."

Even so, problems can pop up in unlikely places. Freddie and Fannie's earnings took a hit in 2003—\$212 million and \$511 million, respectively—when assets backed by mobile-home loans soured. Fannie owned roughly \$10 billion worth of such debt; Freddie, \$2 billion.

Meanwhile, Congress is pushing the two to extend more credit to low-income borrowers. But doing so means making a deeper dive into subprime. ■

—With Mara Der Hovanesian
in New York

GOVERNANCE

HOW SWEET IT IS AT MAGNA

The CEO of the parts maker that could buy Chrysler runs the company his way

BY DAVID WELCH

ON FEB. 27, MAGNA International Inc. announced a controversial decision to cut its dividend in half. The move angered some shareholders, but the Canadian parts maker said the cut was prudent given the tough times in the auto industry.

That explanation fails to account for one thing: Over the past nine months, Magna bought two golf courses from an entertainment company run by Chairman Frank Stronach, spending \$84 million on the purchases. That surpasses what was saved by the dividend cut. "That's our Frank," says Claude Lamoreaux, chief executive of the Toronto Teachers Pension Fund, which now has less than 1% of Magna stock after dumping a chunk of it last year. "He's a successful entrepreneur, but then you have these transactions that many people find questionable."

Outside investors aren't the only ones anxious about the business practices of Stronach, whose company has emerged in recent weeks as a leading candidate to buy Chrysler Group. In May, four longtime board members (out of 12) will be resigning. The company says the timing is "a coincidence," but one director and sources close to the board indicated that some of the departing directors grew tired of trying to keep Stronach from straying away from the core parts business and making moves that upset shareholders. Three of them—lead director Edward C. Lumley, Canadian investor Royden R. Richardson, and retired Ford Motor Co. executive William H. Fike—were independent board

members. Lumley wouldn't state his reason for leaving but conceded that there has been tension between a few board members and Stronach. "Let's just say there has been some debate over the years, and leave it at that," Lumley said in a brief telephone interview. "I just had a conversation with our largest shareholder, who wasn't happy about the dividend. This isn't the first time I had been asked to talk to shareholders." Stronach declined to speak to *BusinessWeek*.

FIRM GRIP

A CLOSE LOOK at Magna reveals a complex and interesting company. True, Stronach is a brilliant entrepreneur who delivers results. The company made \$528 million last year on revenues of \$25 bil-

lion, even as many parts makers succumbed to bankruptcy.

But there's another side to Magna's indomitable chairman, a side some investors don't like. Although Stronach owns just 5% of the common stock, he controls the business outright, with 67% of the Class B voting stock. Critics complain he is overpaid and uses his power to approve rental agreements and other real estate deals between Magna and companies he controls. Board members say they've had to wrestle with Stronach to keep Magna from diversifying away from the parts business and into riskier ventures such as Stronach's passion, Thoroughbred racing. "It wasn't just one thing," says the departing Richardson. "You're constantly in a position of having to look out for the shareholders. They don't have a loud voice."

While he

Beefs with Frank

HIGH SALARY: Stronach has earned an average of \$34 million a year over the past five years, several times what CEOs earn at rival parts makers

LAND PURCHASES: Magna has disclosed several real estate transactions in which the parts maker paid other Stronach companies for golf courses and other property

RENT: Magna doesn't own most of the property it occupies. Instead, it rents offices and many of its factories from another company controlled by Stronach



respected in the auto industry, Stronach is few fans in the corporate governance movement. He started Magna in a game 50 years ago and has been known to take a cavalier attitude toward complaints. When shareholders challenged his salary in 2004, he told Toronto's *Globe and Mail*: "It's a free country. If they don't like it, they could sell their shares."

Such views are more common in Canada, where major companies such as Rogers Communications, Shaw Communications, and CanWest Global Communications have similar structures with powerful controlling stockholders. "The U.S. is further along in terms of reforming corporate governance," says Joseph R. D'Cruz, a business professor at University of Toronto's Rotman School. "We still have a number of companies with crony boards."

Even by Cana-

dian standards, though, Magna is exceptional. Shareholder activist groups see the golf course transaction as just another cozy deal between Stronach's enterprises. Lamoreaux says arrangements like that are the reason Magna routinely ranks toward the bottom of the *Globe and Mail*'s corporate governance survey. "I would question why the board would approve the purchase of two golf courses. The stock isn't in my [personal] portfolio," says Lamoreaux.

Magna offers an explanation for the acquisitions: Both courses abut Magna headquarters and offices. Executives have used the country club and its facilities to hold company meetings and events and paid up to \$7 million a year to rent them. Buying them would eliminate rent

payments. Because Magna Entertainment Corp. (MEC) put the property up for sale, Magna was also worried a

new buyer would acquire it, leaving the company without easy access to the course. Magna adds that the deal was reviewed by a committee of independent directors.

Other issues raise eyebrows. Canadian shareholders have long complained about Stronach's salary. Since 2002, he has paid himself \$168 million, for an average of nearly \$34 million a year, according to the company's annual reports. His pay amounts to 3% of profits in a typical year. By comparison, Johnson Controls Chairman and CEO John Barth made \$14 million in cash and stock—1.4% of profits—running a larger parts company with double Magna's 2006 earnings. Magna notes that independent directors approve Stronach's pay.

JUGGLING INTERESTS

THEN THERE IS the matter of real estate. MI Development owns Magna's offices and many of its factories. Stronach is both chairman and controlling shareholder of MID, which has charged Magna \$425 million in rent payments since 2003, according to financial statements. Magna argues that selling those properties to Stronach's real estate firm freed up cash. Also, since the real estate business was later spun out, with some shares going to Magna stockholders, the company created value for its investors. When Magna spun off the real estate outfit back in 2003, the company said it would make 11% re-

turns on the Magna properties and had built-in rent increases. That may be fine, but with Stronach acting as chairman of both public companies, he must juggle the responsibilities of making strong rental profits for MID while keeping costs in check for Magna. The company says that all of the leases are for "fair market value" and vetted by independent directors.

Despite questions about pay and governance, there's a reason shareholders tolerate Stronach: He posts good numbers. To Magna's owners, he is to the parts company what Steve Jobs is to Apple Inc. "Frank created this company from his bare hands," says Boston University business school dean Louis Lataif, who sits on the MEC board and joins Magna's board next month. "I wouldn't be associated with this if I thought there was anything devious. There may be things controversial, but not devious." ■

Stronach had to be steered away from racing ventures





The iPhone's German Accent

Little-known Balda is the likely pick to build the touch screen for Apple's newest gadget

BY JACK EWING
AND ARIK HESSELD AHL

LAST YEAR WASN'T EXACTLY auspicious for German mobile-phone components maker Balda. The company issued two profit warnings, shed 70% of its 2,400 German workers, and ended the year with a loss equal to 13% of sales. So why would a heavy hitter such as Apple Inc. hand Balda a contract to make the touch screens that are the most important design element of the much-anticipated iPhone?

Although neither Balda nor Apple has actually said the German company is going to make the displays, it's an open secret in the industry that Balda has the job. It's the only company in the world currently capable of producing the millions of advanced small-format displays that Apple will need. And Apple isn't the only reputable company betting on Balda,

which is hardly a household name even in Germany. Nokia, Motorola, and Sony Ericsson are Balda customers, and lots of smart investors are grabbing shares of the company based in the northwest German spa town of Bad Oeynhausen. Fund manager FMR Corp., better known as Fidelity, and New York-based Wyser-Pratte Management Co., have both bought big stakes in recent months.

They're not crazy. Although Balda was better known as a maker of plastic shells for cell phones, a well-timed deal with a Chinese producer of touch screens catapulted the German company into what looks like a profitable new business. With the Chinese technology, Balda now makes glass-surfaced screens that are far more sensitive, thinner, and harder to scratch or smudge than the plastic displays that now dominate. They offer sharper resolution, and unlike conventional touch screens—which get confused by more than one finger at a

time—Balda's displays can sense several human digits simultaneously. Apple, which plans to launch the iPhone in June, has already patented software that would allow a user to place thumb and forefinger on the display, then spread them apart to magnify an image. What Balda has done "seems to be far ahead of the competition," says investor Guy Wyser-Pratte, who has 7% of Balda and says he's still buying.

Balda's reversal of fortune is remarkable considering the rough patch it went through just a few months ago. It got slammed last year when Taiwanese electronics maker BenQ Corp., a major customer, declared its German handset operations insolvent barely 12 months after buying the business from Siemens. In addition, Balda's core business of handset casings suffered as prices plunged. Overall sales fell 7%, to \$482 million in 2006, while the company suffered a pretax loss of \$64 million, almost the same as its year-earlier profit. Balda's shares slumped nearly 60% from April to October, when management issued a second profit warning. "It was a year of turmoil," CEO Joachim Gut told reporters on Mar. 28.

It might be more accurate to say that Balda underwent the corporate equivalent of simultaneous organ transplant.

On Display

How Balda's screens help make the iPhone cool:

- Surface is harder and more scratch-resistant than existing screens
- Resists smudging, essential for a device that's operated with fingers
- The phone housing and display are a single unit, allowing for extra-thin design
- Capable of sensing taps by several fingers at once

Data: Balda, BusinessWeek

the company sold five of its six German factories, then opened new facilities in China and India. And Balda bought 50% of TPK Holding, a Xiamen (China) company that had the crucial touch-screen technology. Although Balda had no experience in touch screens, its connections to the chip handset makers will likely open up new markets for TPK, and Balda says capacity may soon double to 70 million displays annually.

Initial skepticism about Balda's transformation was huge. Analyst Nicolas Stachelberg of German bank Sal. Oppenheim Jr. even flew to China to make sure that TPK was everything Balda claimed. Stachelberg came away impressed by TPK's modern campus and Michael Chiang, its Taiwanese founder. Chiang's family acquired 15% of Balda as part of the deal and is now the combined company's biggest shareholder. "He's a very energetic entrepreneur type," says Stachelberg, who later upgraded Balda shares to a "buy."

AGGRESSIVE POTENTIAL

THERE ARE DOUBTERS who still wonder whether Balda can make the acquisition pay off. The company has promised to boost pretax profits this year to at least \$5 million on sales of \$845 million—a goal some analysts say is a stretch. On Apr. 29, Düsseldorf-based bank WestLB upgraded Balda shares to "sell," warning of "significant risk" that second-half sales won't be as spectacular as management expects. Further down the road, other touch-screen makers such as California-based Synaptics Inc. may be able to ramp up production enough to compete. Although Apple declined comment for this story, the company likes depending on one supplier for important components and typically encourages rivals to join the fray.

But most investors are still bullish. Balda's shares have jumped by 55% since the November low point. Fidelity has increased its stake to 10% since disclosure; a 5% holding in March, though the fund company declined to comment. The likely reason for the optimism: The iPhone may encourage more creative use of touch screens in other handsets, as well as gadgets such as MP3 players, medical equipment, and perhaps even appliances like toasters and refrigerators. "This touch-screen technology has aggressive potential," says Michael Treichl, managing partner of London-based fund Alley Capital, which owns some 8% of the company. "Balda is in a good position to take advantage of it." ■

WIRELESS WARS

New Music Phones—Without the i

BY CLIFF EDWARDS
AND ROGER O. CROCKETT

How do you steal the spotlight from Steve Jobs? It's not easy, but with two months to go until the debut of Apple Inc.'s iPhone, wireless carriers are pinning their hopes on snazzy new devices from Samsung, LG, and Nokia. The names of two of the new phones say it all: UpStage and enV.

No one knows whether the iPhone will be a runaway success when it hits Apple and Cingular Wireless stores in June. But the combination phone-music player got rave reviews at its unveiling in January, and few are willing to bet against CEO Jobs' track record. The tension is even higher because the iPhone is arriving at the same time that Sprint-Nextel, Verizon Wireless, T-Mobile, and Cingular are trying to sign up as many well-heeled, data-hungry customers as possible to offset the high costs of building third-generation wireless networks. That explains why so many phone discounts and 30-day "test drives" are suddenly available.

Industry watchers say such pricing and marketing moves clearly aim to steal the limelight from the iPhone. They also anticipate a surge in multimedia features, despite phone users' heretofore tepid interest in downloading music or video to their phones. Sprint may be the most aggressive of the lot. This month it began selling Samsung's UpStage on an exclusive basis. The candy-bar-shaped device looks like a cell phone on one side and flips over to reveal a full media player on the other. Including an add-on battery and a case, it will sell for just \$149—well below cost—with

a two-year contract. In addition, Sprint has slashed the price of its over-the-air music-download service to 99¢ a track, from \$2.50. Verizon matched a Sprint offer to give new customers 30 days to decide whether they want to continue their service. But Verizon also let dissatisfied customers pay only for the data they used.

The carrier recently rolled out LG's enV multimedia phone and plans to sell similar devices from Samsung and Motorola. In

SAMSUNG'S UPSTAGE



The names of two new phones say it all: UpStage and enV

early April, T-Mobile began selling the \$250 Nokia 5300 Xpress Music at a \$150 discount.

All these phones have clear, large, color screens and impressive sound quality. A couple of relatively new Verizon models include an antenna to grab television signals. The UpStage even uses a touch pad for navigation that's similar to what Apple promises, if not as easy to use. Alana Muller, Sprint's director of wireless data programming and marketing, says UpStage's timing is "serendipitous," adding: "We didn't plan this because of Apple." Jim Ryan, Cingular's vice-president for

data product management and business marketing, calls it an act of "desperation."

While each carrier is arming itself with new gizmos, the victor ultimately must deliver a great experience as both a phone and a media player. The makers of the new Sprint, Verizon, and T-Mobile phones have been criticized in the past for multimedia software that is too complicated for average users. Elegantly simple software is precisely the advantage Apple brings to computers and music players—and which, Apple fans predict, it will bring to phones.

COMMENTARY

BY CHRISTOPH GUTTENTAG



The College Crunch: Why Getting In Has Gotten So Tough

At Duke, there were 19,170 applicants for only 1,665 spaces

FOR MANY AMERICAN FAMILIES, March Madness refers not to a basketball tournament but to the ever-increasing anxiety in the weeks before colleges mail their acceptance letters. As dean of admissions at a prominent U.S. university, I hear the complaints firsthand. Last week my office sent disappointing news to more than 15,000 students—including almost 800 valedictorians—applying for admission to Duke University.

With the second-highest number of applicants in our history (19,170 for only 1,665 spaces), we had little choice. And my school is not unique. Record numbers of students are applying to record numbers of schools. So many students—not just good ones, but exceptional ones—are getting rejected by so many colleges. That has caused many students and parents to feel the whole college-admissions process is high-stakes, random, or unfair.

In fact, it is far from random, and it helps to look at how the process evolved. In the 1980s, all of us working in college admissions were petrified at the then-declining number of 18-year-olds. There was talk of colleges closing because there wouldn't be enough students to fill the available slots. So we all ramped up recruiting, more students applied, and most colleges survived intact. In fact, they thrived. And we all learned that a larger pool of applicants yielded a more talented and engaged class that was closer to our ideal. So nobody wanted to turn back the clock; if anything, we increased recruitment even more. As a result, the past 20 years have seen a jump in the number of college applications far exceeding the rise in the number of 18-year-olds. And colleges don't expect to reduce their recruiting efforts anytime soon.

Recently, a self-perpetuating element has come into play as well: Selective colleges attract more applicants simply by virtue of their ever-increasing selectivity. And anxious students, less certain of their chances, apply to more colleges, resulting in even greater selectivity at a wider number of colleges—and more anxiety.

Ultimately the admissions process lies (somewhat uncomfortably) at the intersection of the interests and aspirations of individuals, institutions, and society. We should not be surprised that both applicants and colleges act in their own self-interest, just as we expect businesses to compete, consumers to be savvy, and society to allow as much choice as possible. And most admissions staff consider a wide range of factors in the admissions process, a task more complex and personal, and less predictable, than admitting students on the basis of their academic work alone.

That's not all bad. For years, many of us have made a conscious effort to bring together on campus students of varying backgrounds, values, and experiences, enhancing their education and their preparation for the real world. We've worried about pricing out the middle class. And, keenly aware that the admissions process does not take place on a level playing field, colleges have been more active in reaching out to talented students who might otherwise be overlooked. That expanded access has meant more competition for a relatively fixed number of slots at some schools.

Still, we in admissions need to support the calls for colleges to be more transparent in their decisions and more reasonable in their expectations of students, for parents to help their children relax a bit, and for high schools to focus more on the process of education than just the result.

Finally, we need to remind ourselves that the media's focus on a very small number of so-called elite colleges and the public's obsession with seemingly objective college rankings, dramatically distort the public's understanding and appreciation of the many exceptional opportunities for higher education available in our

country. There are dozens, if not scores, of good options for virtually every student who wants to go to college. Every senior can find more than a few colleges that would be comfortably challenging, and affordable. The more we keep this in mind, the easier it will be to remember that the quality of an education has more to do with a student's work than with a college name. The beneficiaries, of course, will be our children. ■

“There are dozens, if not scores, of good options for virtually every student who wants to go to college”

Christoph Guttentag is dean of undergraduate admissions at Duke University and a former associate dean at the University of Pennsylvania.

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AUSTRALIA

A YANK ON THE FIRING LINE

Sol Trujillo is raising hackles as he remakes former state-run telco Telstra

BY BRUCE EINHORN

SOL TRUJILLO IS TRYING hard to fit in. Since taking over at Australia's Telstra Corp. in 2005, the former chief executive officer of US West Communications Inc. has sparred with politicians, regulators, and the media over his plans to remake the country's leading telephone carrier. But on a recent visit to Adelaide, capital of the state of South Australia, Trujillo went out of his way to prove he's no outsider. He sprinkles his speeches with references to "barbies" and a local stock car race, and he mentions that Adelaide is his wife's favorite city Down Under. At lunch he extols the benefits of Telstra's transformation from a state-run monopoly into a profit-driven corporation. "We are empowering customers across Australia, including Southern Australia," he says.

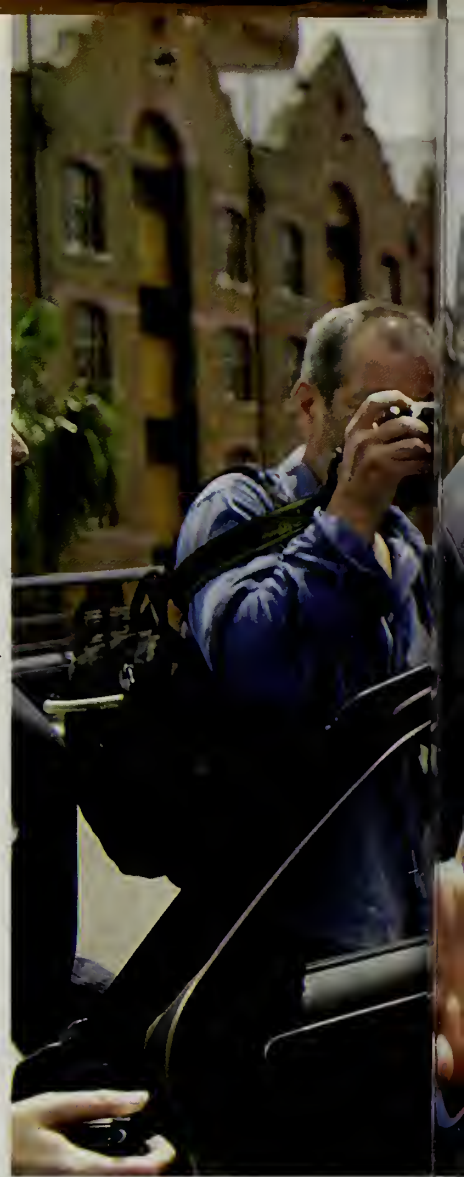
Insider? Well, maybe not quite yet. Business leaders in the audience are too polite to point out that their state's name is South Australia, not "Southern Australia"—a gaffe Trujillo makes five times in his 15-minute speech.

Boning up on Australian geography may be the least of Trujillo's problems. Two years after taking the job, the 55-year-old Wyoming native still has plenty of work left in turning

around Telstra. When Trujillo arrived in Australia, the company was losing market share at home, a plan to expand in Asia had gone bust, and its stock was sagging. "It was like AT&T in 1984," when U.S. regulators ordered the breakup of the phone monopoly, recalls Trujillo. "This was a company that needed an end-to-end transformation."

For Trujillo, that's both a business and a cultural challenge. Profits for the six months through December fell 21%, to \$1.3 billion, on revenues of \$8.8 billion, as Telstra has fought off new rivals in fixed-line and cellular services and grappled with the threat posed by free Internet calling. Its CEO, meanwhile, must contend with an often hostile local press that, much to his irritation, isn't shy about making references to his Hispanic heritage, routinely branding executives he has brought in from the U.S. as his "amigos."

Despite the ribbing, Trujillo can point to some successes. Last year, Telstra finally freed itself from government control after politicians in Canberra agreed to pare back the state's holdings from 51% to 17%. Robust growth in the company's wireless division has helped offset the decline in its traditional fixed-line business. And Telstra's shares, which sank in the wake of Trujillo's appointment, have



rebounded and now stand 28% above their 12-month low in mid-October. Key to the turnaround is what Telstra calls "Next G," an \$816 million ultrafast cellular network that allows users to, say, download a song in less than a minute about one-fifth the time it might take on already-speedy 3G mobile networks. Trujillo boasts that subscribers to the new service are five times more likely to buy music or make video calls, which translates into a 35% increase in revenues per customer.

SCUTTLE DIPLOMACY

THE NEXT G ROLLOUT has also provided Telstra's chief with a welcome diversion from his nasty fight with regulators. Last August, Trujillo ditched plans to build a fixed-line broadband network that would have provided half of all Australian households with super-fast Internet connection speeds. Telstra reversed course because Australia's Competition & Consumer Commission, in a bid to spur competition, was pressing the carriers to

BOUNCING BACK



Data: Bloomberg Financial Markets



TRUJILLO The CEO is in pitched battles with both regulators and competitors he calls "the Nine Dwarfs"

critics who say such tactics might offend politicians. Down Under, he's unapologetic. "Where we come from, that's why you have politicians—to have someone to offend," Burgess says. "If you don't want to be offended, you shouldn't be in politics."

That attitude feels like a welcome change to some of Telstra's rank and file. In the past, many of the company's workers were embarrassed about its sorry reputation. "Sol has taken on the big issues. He's not concerned about the criticism he gets," says Mark R. Bolton, a Telstra regional manager who attended a pep rally for 500 workers during Trujillo's Adelaide visit. "It's absolutely refreshing," adds Bolton, who tends to Telstra's customers in the Outback, some of whom are so isolated that it can take six hours to reach them by car.

But is Trujillo's chest-thumping effective? David Kennedy, a research director for Ovum-RHK in Melbourne, isn't sure it's doing much to win over Australia's regulators and leaders. "There has been a lot of heat and noise," says Kennedy. "But I haven't seen any evidence that it has had a political impact yet."

Indeed, as far as Telstra is concerned, the political climate may be taking a turn for the worse. On Mar. 20 the opposition Labor Party announced a proposal to sell about \$3.7 billion worth of the government's remaining stake in Telstra and use the funds to build a national broadband network open to Telstra's competitors. With Labor in the lead heading into next year's national elections, Trujillo may have to work that much harder to fit in. ■

—With Paula Lehman and Cristina Lindblad in New York

on the network to other operators. The high-talking Trujillo fumes at the notion that rivals such as Vodafone Group and Singapore Telecom Ltd.'s Optus should be allowed to piggyback on his company's multi-million-dollar investment. "It's a parasitic model," he says of the government's policy. The ACCC declined comment, but Australian Prime Minister John Howard has said he will not be "blackmailed" by Telstra. Trujillo isn't shy on his competitors, either, calling his companies lobbying for access to the national network "the Nine Dwarfs."

That's trademark Trujillo, say those who know him from the U.S. "Sol's not one to shy away from a fight," says Robert E. Knowling Jr., who worked with Trujillo at US West from 1996 to 1998. When Trujillo took over the Baby Bell in 1995 the company was struggling with the loss of its monopoly, and customers hated it for being slow and stodgy. "People called it US Worst," but Trujillo made great strides in improving its service record, says Knowling, now

CEO of Vercuity Solutions Inc., a Colorado company that provides business services to the telecom industry. Trujillo left US West in 2000 after shepherding the outfit through a merger with Qwest Communication International Inc. In 2001 he joined the board of Orange, the cellular carrier owned by France Telecom. In 2003, he became the company's CEO, a job he held for 13 months.

These days, Trujillo insists, he's not picking a fight with Australia's regulators. He says he's just sticking up for Telstra shareholders and employees. To that end he appointed Phil Burgess, a pugnacious American who was an advisor to US West. His job is to drum up support among investors and workers for Telstra's stand against the government. Burgess has fielded a rapid-response team of bloggers who use a new Telstra-sponsored Web site to counter negative coverage in the mainstream media. To

Australia PM John Howard has said he will not be "blackmailed" by Telstra

CoverStory



Mittal & Son

An inside look at the dynasty that dominates steel

BY STANLEY REE



DEEP INSIDE THE BEAUX ARTS PALACE IN LUXEMBOURG
It serves as headquarters of steel giant Arcelor Mittal, a half-
dozen men in their forties and fifties listen intently as plant
managers from around the world file in to make presentations.
This is no bunch of lightweights: Almost everyone at the table
has decades of experience in the steel industry. The lone excep-
tion is 31-year-old Aditya Mittal, the baby-faced chief financial
officer and son of the founder and chief executive, Lakshmi
Mittal. But in this room full of veterans, he's the one who's

really calling the shots. When Louis Schorsch, who heads the
company's operations in the Americas, brings up the delicate
topic of personnel problems at one important plant, it's Aditya
Mittal who responds. "Feel free," Mittal says impassively, "to
change the management."

Tough words, chilly delivery. This
kid doesn't fool around. Aditya's
father isn't at the meeting, yet ev-
eryone knows the trim, serious son

FAMILY AFFAIR

Aditya and Lakshmi
Mittal have made
power-sharing work

has Lakshmi Mittal's full backing. That's nothing new. Despite Aditya's tender years, he has worked with his father for a decade and is his closest confidant. The pair is today the most powerful father-son duo on the global business stage. Together, the Mittals have come to dominate one of the oldest, most elemental businesses on earth. In the process, they've helped revive a flagging industry—and created staggering wealth. The Mittals' 45% stake in Arcelor Mittal is worth \$33 billion, ranking them among the world's richest families.

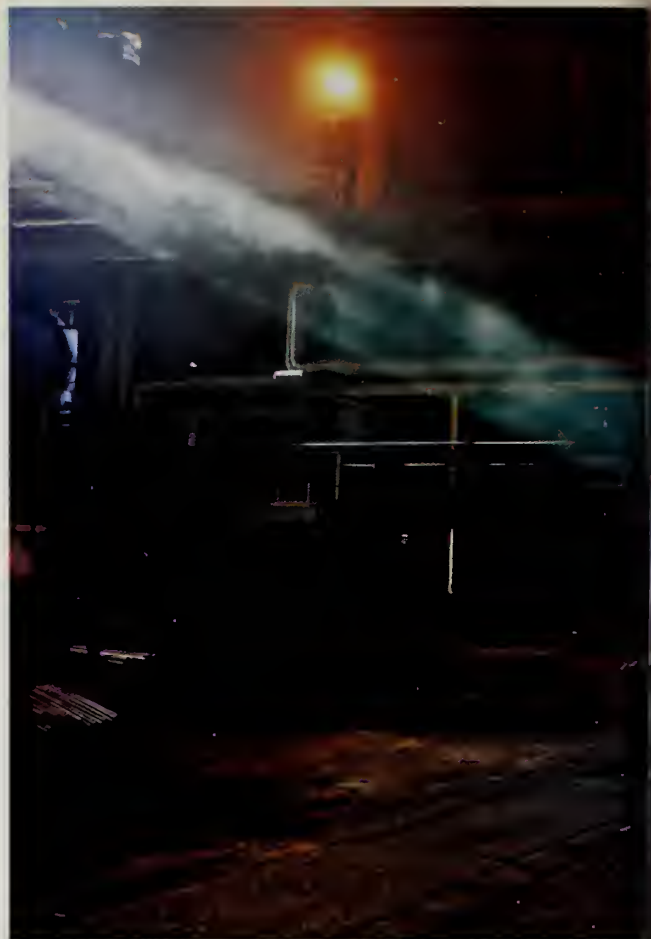
You may well know Lakshmi Mittal. His company is responsible for 10% of world steel output. He lives in a 12-bedroom London mansion with butlers on call and a Picasso on the wall. And he famously dropped \$55 million on his daughter's wedding, which included a party at Versailles. Few outside the steel industry, though, know much about Aditya and the outsize role he plays in his father's success. Where the 56-year-old Lakshmi is the steel industry visionary, Aditya is the financial dealmaker. The smooth, Wharton-educated son pushed for the \$38 billion takeover of Arcelor, the giant European steel company, then helped hammer out every aspect of the deal that closed last June.

A Rare Case

AT THE HEART OF THEIR SUCCESS is the Mittals' powerful bond. In many a family dynasty, sons and daughters are either desperately trying to win their father's approval or deviously plotting to overthrow the old man. But the Mittal team seems to be a rare case of inter-generational respect and shared power. Lakshmi has given his son the running room he needs to build and shape the company. Aditya, in turn, is smart enough and confident enough to learn from his dad at every turn. "A father and son in business is usually a pretty tricky, complex relationship," says Mittal board member Wilbur Ross, who sold his American company, International Steel Group, to the Mittals in 2004 and who has \$250 million invested in Arcelor Mittal. "But in this case, it seems to work just fine."

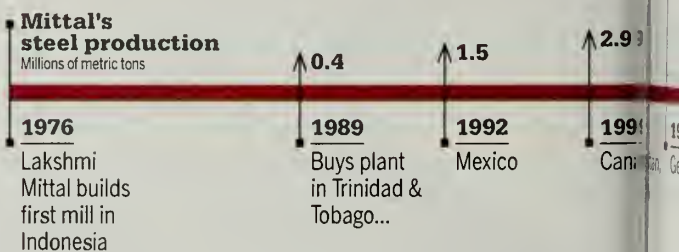
One reason it does may be that the Mittals are in many ways very different. The son of a traveling salesman, Lakshmi lived in a poor and remote Indian village without running water until the age of five. His father later started a small steel mill, giving young Lakshmi a taste for the business. Lakshmi, in turn, went on to found his own steel company, developing the instincts of a from-the-gut manager. Aditya grew up as the cherished only son of a rising entrepreneur, then was dispatched by his father to the U.S. to acquire the financial skills that can only be had in the West.

Rough-hewn father, polished son: The two are part of a larger theme in India Inc., even though the Mittals now operate from London. One Indian family after another—the Ambanis of Reliance, the Premjis of Wipro—has strengthened itself by dispatching its children to Britain and the U.S. for schooling. Lakshmi is comfortable chatting up line workers and still knows how to operate the electric arc furnaces used to turn scrap into molten metal. Aditya feels more at home with a Wall Street crowd, enjoys scuba diving and skiing, and has become a master dealmaker.



Men of Steel

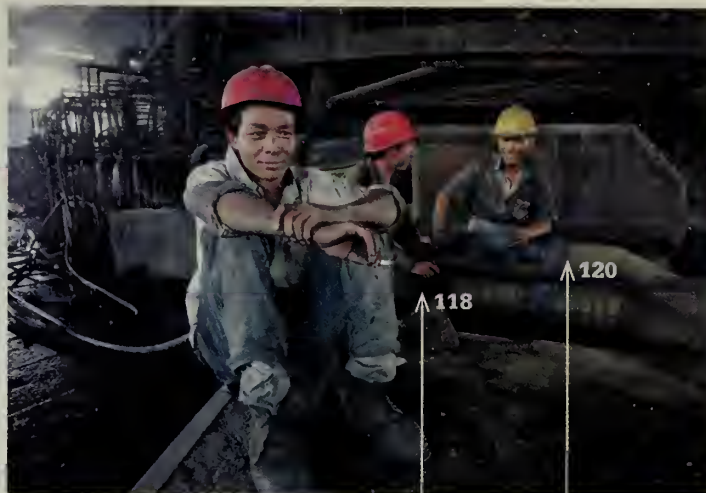
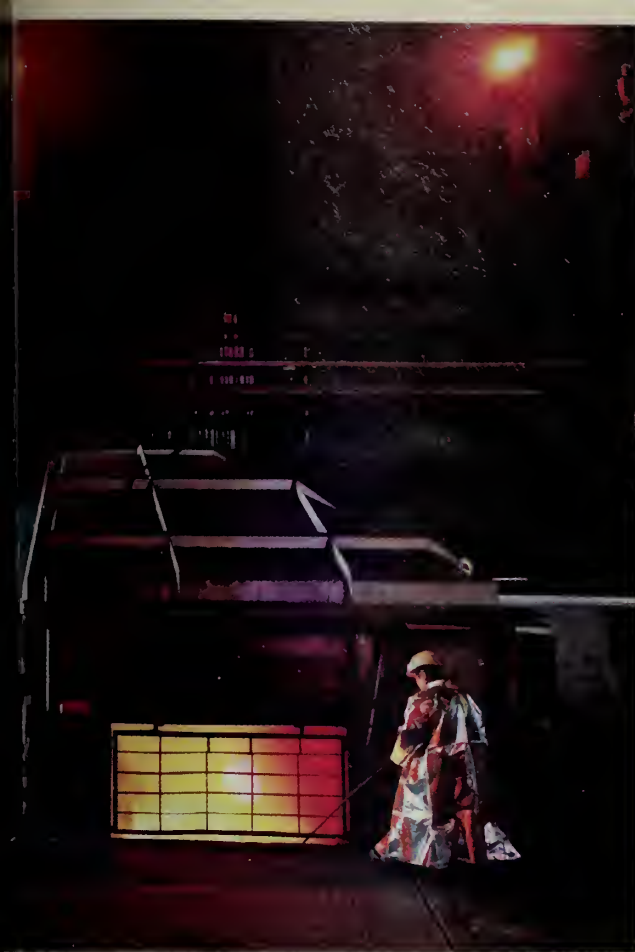
The Mittals have created an empire, one step at a time



They're also free of many of the social and cultural constraints that so often hamstring business in both Europe and India. The Mittals are Marwaris, a group from the Indian state of Rajasthan known for producing shrewd merchants. But Lakshmi built his business first from Indonesia and then from London and is seen as something of an outsider in his homeland. As a result, he has become a kind of world citizen without roots.

Both father and son can be equal parts cunning, tenacious and tough—if not downright ruthless—pushing aside anyone

The question is whether the son is pushing the father too far. The Arcelor deal put the company \$20 billion in debt



GLOBAL SPAN
Mittal workers in
Germany (left) and
Inner Mongolia (above)



Data: Arcelor Mittal, Credit Suisse

their way. They are legendary for their long meetings, fueled by little more than green tea and sandwiches. The Mittals have cooled, sweet-talked, or outwitted legions of steel executives from every corner of the planet. When they decide they want something, they don't give up. "You can't say no to that man," one steel executive says of Lakshmi. The Mittals, for instance, negotiated through three years of shifting political winds before winning a steel plant in Romania.

The question is whether the son is pushing the father too far. There's no doubt that Lakshmi Mittal embraces risk: He built his empire by taking over fading steel mills that no one else wanted. But with Aditya in charge of mergers and acquisitions, the Mittals have shifted their business away from snapping up dirt-bucket plants on the cheap. Instead, they're now paying top dollar for some of the best mills in the industry. The Arcelor deal meant loading up the company with debt, now totaling about \$50 billion. Any slump in demand combined with a surge of

steel exports from China could make it hard to pay that off.

The Mittals argue that they have made their business more stable by increasing its geographical breadth. Despite a recent slump in U.S. prices, Arcelor Mittal is throwing off cash by the ton. It reported operating income of \$11.8 billion on sales of \$88.5 billion last year. And investors don't seem too worried about the debt load: The stock has surged from the low 30s to 54 since the two companies began working together in August.

Over the decades, the Mittal strategy has been nothing if not consistent. The story starts back in 1978, when Mittal opened his first mill in Surabaya, Indonesia. Although demand was slack in the U.S. and Europe, the industry was booming in Asia. Lakshmi came to believe that steel companies could churn out heavyweight profits if they grew big enough to negotiate on an equal footing with suppliers of iron ore and coal and with customers such as automakers. That has

been Mittal's organizing principle straight through to the Arcelor deal. Now the Mittals have the power to ramp up or slow down production depending on local demand. In the long run Lakshmi's vision is an industry dominated by a handful of powerful companies, strong enough to cut output rather than prices in a downturn.

Aditya's dealmaking is helping turn his father's vision into reality as the pair play a key role in rehabilitating the steel business, not long ago the troubled stepchild of global industry. Hungry predators are now paying enormous prices for once-scorned companies such as Britain's Corus Group, which India's Tata Steel bought for \$12 billion on Apr. 2. "The Mittals have made steel a more stable business that is accessible to investors," says Dalton G. Dwyer, managing director of Industry Corporate Finance Ltd., which specializes in industrial M&A.

While his father zips around the globe in his Gulfstream G550, dining with presidents and potentates, Aditya bears down on the nitty-gritty details. He's in charge of forging one company from the lean-and-mean Mittal Steel Co. and Arcelor, an amalgamation of three long-coddled European enterprises. His No.1 job is squeezing a promised \$5.3 billion in savings and revenue gains from the new company by 2008. Since August he has also been the board member overseeing most operations in the Americas: four plants in the U.S., as well as mills in Canada, Mexico, Chile, Argentina, and Brazil.

Although he's young—and looks even younger—Aditya is no newcomer to steel. He has been on the job since he was 21 and, in fact, got his start much earlier. Aditya was born in Kolkata in 1976 but while still an infant he moved with his family to Indonesia, where he attended the 110-student Surabaya International School. "It was a very simple life," he says. With little other amusement available, as a teenager he often tagged

BORN 1950, Sadulpur, Rajasthan, India

EDUCATION St. Xavier's College, Kolkata, 1969, Bachelor of Commerce

WIFE Usha Mittal

CHILDREN Son, Aditya; daughter, Vanisha Mittal-Bhatia

FIRST JOB Running errands for his father's steel business

HOME 12-bedroom, \$100 million mansion in London, at the time of purchase the most expensive private residence on earth

PREFERRED TRANSPORTATION Maybach limousine, Gulfstream G550

SOCIAL LIFE Dining with presidents and prime ministers

OFFBEAT SKILL Can operate furnaces in his steel mills

SPORTS Badminton, cross-country skiing



along on his father's troubleshooting missions at the plant where he loved to watch the furnace swallow scrap metal with a roar like rolling thunder. "I used to spend Saturday nights at the melt shop," a cavernous space with giant ladles full of molten steel, he recalls.

The Mittals now have a rule, not always obeyed, of not talking about work at home. Yet when Aditya was growing up it was all business, all the time, allowing the son to soak up both his father's love of the industry and his acute sense of strategy and timing. "He would tell me about his travels, what companies he had bought," Aditya remembers. "I would go to his office, hang around, and talk to the people there."

As a result, Aditya has steel in his blood. Just about anyone in their empire can recount tales of visits from the Mittals, who often remember individual workers from tours even years earlier. They ask pointed questions about operations and

The Mittals turned a brutal steel slump into an opportunity to double their capacity cheaply and quickly



ADITYA MITTAL



BORN 1976, Kolkata

EDUCATION University of Pennsylvania Wharton School, B.S. Economics, 1996

FIRST JOB Credit Suisse First Boston

WIFE Megha Mittal

CHILDREN Daughter, Sanaya

HOME London's posh Belgravia neighborhood

PREFERRED

TRANSPORTATION Helicopter to airport, then private plane

CAREER HIGH Touring Luxembourg with Prime Minister after winning Arcelor deal

SATURDAY NIGHTS IN HIGH SCHOOL At the melt shop of his father's steel mill

SPORTS Scuba diving, downhill skiing

tional from many of the steel assets Mittal had been buying. "I always believed [a stock offering] would open up more opportunities," Aditya says.

He quickly found his role. Aditya showed a mastery of numbers and had a nose for sniffing out targets, so in 2000 Lakshmi put him in charge of M&A. It was a tough time, though, for Aditya to cut his teeth. A brutal steel slump that led to a wave of bankruptcies had sent Ispat's shares plummeting from an IPO price of 27 in 1997 to just 1.50 in late 2001, and the company's \$2 billion Mexican operation was teetering on the edge of default.

But the Mittals turned the crisis to their advantage. They snatched up plants in Eastern Europe and Algeria at rock-bottom prices. Capitalizing on the desire of many governments to shed money-losing assets, and backed by favorable financing from the World Bank and the European Bank for Reconstruction & Development, the Mittals doubled their annual production

quire whether requested improvements were made. "They're in love with steel just like we are," says Gonzalo Urquijo, Arcelor's former CFO and now a member of the combined company's board. But they're also demanding. U.S. employees call meeting a 90-day deadline for relining a blast furnace, despite losing more than two weeks to a mechanical problem. Lakshmi's reaction? "So next time you can do it in 72 days."

Numbers Man

WHEN ADITYA SET OFF FOR WHARTON in 1993, he had no intention of immediately joining the family business, hoping instead to work in finance. There, he met his future bride, Megha, who for months refused to give Aditya the time of day. Yet again, his tenacity worked to his advantage. "I made sure I had a lot of opportunity to spend time with her," Aditya says. "Eventually all my hard work and persistence paid off." The two were wed in 1998, and last summer, just days after the Arcelor deal closed, the couple had a baby girl.

His time outside the family business was brief. After graduating magna cum laude, Aditya joined a training program at Credit Suisse First Boston. But he stayed less than a year. He left to help his father create a public company called Ispat Interna-

capacity to 30 million tons over just two years. "Everywhere there was something for sale," says Aditya.

The Mittals' double-or-nothing bet, though, didn't sit well with some Ispat shareholders. Some of the acquisitions were made privately by the Mittals despite assurances in the IPO prospectus that they would only buy steel plants through the listed company. That left investors complaining that the family was privately snapping up quality mills while leaving less attractive assets in the public company. The Mittals counter that purchases in emerging markets at a troubled time for the industry would have been too risky for public shareholders.

Then, in 2004, Aditya helped plug a hole in the portfolio with a big U.S. deal. The company agreed to acquire International Steel Group—which included assets of the old Bethlehem Steel—for \$4.5 billion from Ross, turning the Mittals overnight into top players in the U.S. industry. They used the transaction to clean up their messy public-private structure. Ispat acquired their private company, LNM Holdings, for \$13 billion to create Mittal Steel Co. Lakshmi paid himself a \$2 billion dividend.

When Aditya first hit on the notion of going after Arcelor, his father was less than enthusiastic. Says Lak-

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shmi: "I felt it was a far-fetched idea." While on a ski vacation at the family's house in Saint Moritz, Switzerland, in December, 2005, Aditya made his case. Arcelor was also buying up steel plants, and both companies had bid for a mill just two months earlier in Ukraine. Although Mittal had prevailed, Aditya figured Arcelor's challenge had pushed the price up by nearly 40%, to \$4.8 billion. That helped convince his father. "They were bidding against us on every purchase," Lakshmi says.

The Mittals first tried a friendly approach. Aditya invited

they were cooked when at the end of May Arcelor accepted a rival offer. Dollé agreed to sell a 32% stake in the company to Russian oligarch Alexey Mordashov in exchange for a controlling interest in steelmaker Severstal. "We were all struggling to find a crack in the Arcelor defense," says Shahrar Tadjbakhsh, an investment banker from Goldman Sachs & Co. who worked on the deal. The opening appeared when members of Arcelor's board grew uncomfortable with what they saw as the company's extreme defense tactics and its general refusal to deal with the Mittals.

In June, against Goldman's advice, the Mittals sent a letter to Arcelor. That broke the ice, and Aditya began a series of quiet meetings, paving the way for a deal. Aditya "was the person who probably had the best mastery of key elements of the transactions," Tadjbakhsh says. Adds Jeremy Fletcher, a banker at Credit Suisse in London who also participated: "Arcelor was conceptually very much Aditya's deal."

Such clout is testimony to his father's confidence in Aditya. The two have an easy rapport often finishing each other's sentences. When they're in London the Mittals typically lunch together, with the meal delivered from Lakshmi's mansion. When in different cities, they're on the phone with one another at least twice a day. "There are very few things that we don't talk to each other about," says Aditya, who always refers to his father as

"Mr. Mittal" in front of outsiders. That respect is returned. "I don't see him as young," says Lakshmi. "I admire him for his intellect and for his ideas, suggestions, and convictions."

The knock-down fight for Arcelor put to rest any doubts others might have had about Aditya. He took a beating when Dollé made an issue of nepotism. And Dollé still questions the wisdom of the deal. "Before judging any merger, you have to wait a long time—four or five years," he says. But Aditya sure looks like a winner for now. He tells of touring, like a conqueror, the city of Luxembourg, taking in the opera house and other landmarks. His guide: None other than the Prime Minister. And to seal the deal, the Mittals had promised that an Arcelor executive would hold the CEO post at the combined company, naming Arcelor executive vice president Roland Junk to the job. But three months later, Junk stepped aside. Lakshmi is now CEO, and Aditya is overseeing the integration. His younger sister, Vanisha, also works in the company and serves on the board. Arcelor Mittal's headquarters may be in Luxembourg, Aditya says, but the "power is in London."

The Mittals, like most billionaires, live differently from



INTEGRATION RISKS?
Workers at an Arcelor plant in Dunkirk, France

Arcelor CEO Guy Dollé to dinner in the London mansion. A large painting of a Mogul ruler cradling a falcon presided over the scene; the wine flowed. At one point, Dollé boasted how well Arcelor was doing, further whetting the Mittals' appetite. But after a three-hour meal, Dollé shrugged off any suggestions of a deal.

A Crack in the Defense

AFTER DOLLÉ DUCKED FURTHER MEETINGS, Aditya took the gloves off. An investment banker hastily summoned to work on the bid said the deal was classic Mittal. Their own business was performing well, giving them the nerve to go after the biggest target around. Still, the team wasn't nearly as prepared as their bankers would have liked. For one thing, the regulatory climate of Luxembourg, where Arcelor was headquartered, was unknown territory. "No other corporate entity would have done this," the banker said.

A bitter five-month battle ensued. The Mittals thought

Arcelor had bid against the Mittals in many deals. That persuaded Lakshmi to make it their next target

A photograph of Tiger Woods in mid-swing on a golf course. He is wearing a dark jacket, white shirt, and a dark cap with a white Nike swoosh. A white diagram is overlaid on the image, consisting of a vertical line with a horizontal crossbar at the top, and a diagonal line extending from the crossbar down to the right. The text 'stick-to-itiveness 90%' is written along the diagonal line, and 'intuitiveness 10%' is written along the vertical line.

stick-to-itiveness 90%

intuitiveness 10%

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The big hole in the empire is in Asia, where it has been harder to buy assets than in the rest of the world

the rest of us. Lakshmi is chauffeured around in a Maybach limousine and logs countless hours on his Gulfstream. Aditya, too, can use the jet at will, often arriving at the airport by helicopter. Yet, for all their gilt edges, the Mittals are surprisingly down-to-earth. Sure, they may splurge on a big family event like the wedding, but they're more formal than flashy. And they are intensely private, focusing what little downtime they have on the family's inner circle.

Mostly, though, their lives are about work. As part of a broad shakeup in the U.S., Aditya has brought in new management to

gearing up to use a Sidmar device called a bomb that can be plunged into molten steel to sample its chemical properties and detect imperfections early on. The Mittals are pushing for just that sort of knowledge exchange across the company's global network, from Brazil to Kazakhstan. The many cultures now under the Arcelor Mittal flag provide "an inexhaustible source of competitive advantage," says Greg Ludkovsky, the company's chief technology officer for the Americas.

Stretched Thin

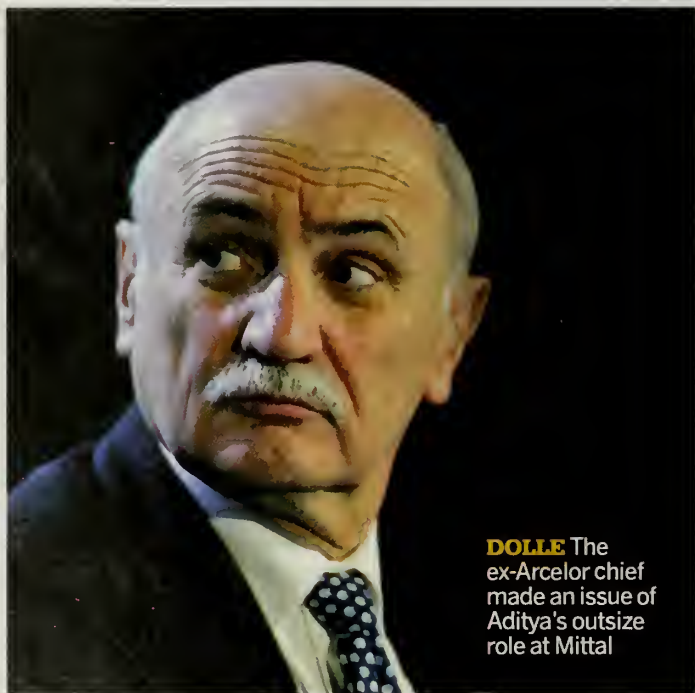
THERE'S STILL A HUGE AMOUNT OF WORK to do integrating Arcelor, which is not as sharp commercially as it is on technology. Competitors say Mittal had its hands full even before the megadeal, and the company's U.S. executives acknowledge they're stretched. They have yet to install common computer systems, for instance. That loss of focus has enabled others to grab business, says Daniel R. DiMicco, CEO of Charlotte (N.C.)-based Nucor Corp. "We've probably gained customers since the Mittals bought ISG in 2004, he says.

The Mittals, though, are already looking ahead to the next deal. They just bought another Mexico plant, they're building a new steel pipe plant in Saudi Arabia, and they may next go after Vallourec, a big French maker of pipes for the oil industry. The big hole is Asia, where state-owned steel plants and national champions have made it tough to buy assets. Some even think the Mittals could make a run at South Korea's giant Posco. They already own 33% of Hunan Valin, a Chinese producer, and they have also agreed to build a \$9 billion plant in the Indian state of Orissa. "If they had Asia exposure, they would have the world sewn up," says Michael Shillaker, an analyst at Credit Suisse in London.

The Mittals have time on their side. Aditya still has many years ahead of him, and so, too, does his father. Will the two always be together? Aditya isn't so sure. "I don't know if I am going to be here for the long run," he says. "It depends on the opportunities and the requirements of the company."

Most give the Mittal father-son act at least another decade. It's when fathers hit their 70s and sons their 40s that such unions start to unravel, as the younger generation itches to take control, says Randel S. Carlock, a professor at the INSEAD business school's Singapore campus. But for now, at least, the Mittal team looks rock-solid. "The father is an entrepreneurial icon, one of the great business leaders of the 21st century. The son is obviously a very capable young man," says Carlock. "That's the best situation you can have."

—With Michael Arndt in Chicago, Nandini Lakshman in Mumbai, and Geri Smith in Mexico City



DOLLE The ex-Arcelor chief made an issue of Aditya's outsize role at Mittal

run a huge mill in Burns Harbor, Ind., on the southern shore of Lake Michigan. He wants the new team to crank up production by 25%, which would make it the most profitable plant in the U.S. That's where Arcelor comes in. Unlike the rattle-trap facilities in developing markets that Lakshmi made his fortune buying, Arcelor isn't a collection of dinosaurs. While the two companies were roughly the same size, Arcelor annually spent more than 10 times what Mittal did on research and development. The best Arcelor plants outperform Mittal mills in efficiency, reliability, and quality of steel.

To tap into that expertise, Burns Harbor recently dispatched a team of engineers to Sidmar, Arcelor's crown jewel, in Ghent, Belgium. The idea was to figure out why, with the exact same inputs, the Europeans were able to squeeze about 7% more steel out of their mills than the U.S. plants could. The Americans relished the candlelight dinners in the old quarter of Ghent, but they were even more wowed by the advanced technology and shop-floor know-how they saw in Belgium. Now, they're

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MORE ON LAKSHMI AND ADITYA MITTAL

ONLINE: Read a Q&A with Lakshmi Mittal on how he is reshaping the global steel industry.

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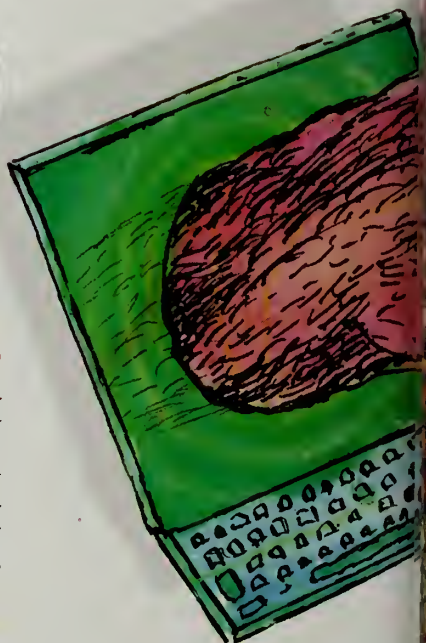
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WEB ATTACK

Nastiness online can erupt and go global overnight, and “no comment” doesn’t cut it anymore. Here’s how to cope

BY MICHELLE CONLIN



MARTIN S. SORRELL, CEO OF advertising agency WPP Group, sues two blogging ex-colleagues for a Web hate campaign in which, he says, they smeared him and his former lover. *The Washington Post* grapples with a surge in online comments that read like the racist garbage on

neo-Nazi Web sites. Home Depot’s CEO goes into an emergency huddle with his crisis management team after 14,000 bilious customers storm an MSN comment room.

The venom of crowds isn’t new. Ancient Rome was smothered in graffiti. But today the mad scrawls of everyday punters can coalesce into a sprawling, menacing mob, with its own international distribution system, zero barriers to entry, and the ability to ransack brands and reputations. No question, legitimate criticism about companies should get out. The wrinkle now is how often the threats, increasingly posted anonymously, turn savage. Even some A-list bloggers are wondering if the cranks are too often prevailing over cooler heads.

Most companies are wholly unprepared to deal with the new nastiness that’s erupting online. That’s worrisome as the Web moves closer to being the prime advertising medium—and

reputational conduit—of our time. “The CEOs of the large 50 companies in the world are practically hiding under the desks in terror about Internet rumors,” says top crisis manager Eric Dezenhall, author of the upcoming book *Damage Control*. “Millions of dollars in labor are being spent discussing whether or not you should respond on the Web.”

In the beginning, the idea of this new conversation seemed so benign. Radical transparency: the new public-relations nirvana! Companies, employees, and customers engage in Webified dialectic. Executives gain insight into product development, consumer needs, and strategic opportunities. All that back-and-forth empowers consumers, who previously were relegated to shouting at call-center minions. Venom can be a great leading indicator.

Trashing brands online can also be high theater. Rats cruising around a Greenwich Village KFC/Taco Bell on YouTube. MySpacers busting their employers’ chops. Faux ads bashing the Chevy Tahoe as a gas-guzzling, global-warming monster. Millions of people watch this stuff—then join in and pile on. It’s any wonder companies lose control of the conversation?

When the Web turns against them, executives are faced with the problem of how to manage the blowback. They have two choices: ignore the smaller furies and hope they won’t metastasize, or respond outright to the attacks. It’s rarely a good idea to lob bombs at the fire-starters. Preemptive



engagement, and diplomacy are saner tools.

Companies such as Lenovo Group, Southwest Airlines, and Dell have specialists dedicated to engaging or co-opting their critics. Dell has made blogger outreach into such a discipline that the company's team, including refreshingly straight-talking blogger-in-chief Lionel Menchaca, recently sat down for drinks, nachos, and fried zucchini at an Austin (Tex.) pub with blogger Jeff Jarvis. He's the man who ignited the original Dell Hell customer-service crusade with his rants about the company. (Jarvis picked up his own tab.) "In a flash he transformed the borgish image of Dell for me," says Jarvis. That wasn't all. At Davos in January, Michael S. Dell sought out Jarvis at a cocktail party and apologized to him.

COUNTER-VIGILANTES

OTHER BUSINESSES HIRE outfits such as BuzzLogic, which uses algorithms to analyze which bloggers and social media are driving the conversation around issues that matter to marketers. For executives there's a new, \$10,000 premium service from ReputationDefender.com that can promote the info you want and suppress the news you don't. The company also claims it can make information disappear altogether. One CEO, it says, watched a negative story about wrongdoing at his company drop from the first page of his Google hits to the third. In another case, ReputationDefender helped focus attention on a financier's recent hedge-fund glories so his previous career as a banker wouldn't overshadow them.

But what happens when the uproar grows so noisy that the mainstream media is bound to pick it up? That's exactly the position new Home Depot CEO Francis S. Blake found himself in last month. MSN Money columnist Scott Burns accused Home Depot of being a "consistent abuser" of customers' time. Within hours, servers were caving under the weight of 10,000 angry e-mails and 4,000 posts, which took the company to task for pretty much everything. It was the biggest response in MSN Money's history. Blake's predecessor, Robert L. Nardelli, the guy who famously didn't allow comments at the company's annual meeting, simply would have ignored the mob. But Blake knew the controversy could quickly mushroom.

The only way over it, he decided, was through it. So Blake penned a heartfelt and repentant online letter to all Home Depot customers, essentially copping to the company's less-



SORRELL The WPP Group CEO sued, then settled with, Web antagonists

than-stellar service. He promised to increase staffing and begged for the chance to make good. He created a site to deal specifically with service. He thanked Scott Burns.

In crisis-management circles, the gamble was viewed as a win. Blake actually generated rare applause on an unofficial Home Depot employee site called the Orange Blood Band where workers are more likely to post riffs knocking the company. ("You can't do it, and we'll never help.")

Of course, the Web is like Whack-A-Mole: For every proactive move, another crisis can flare up elsewhere. Even an innocent comment can backfire. On Apr. 1, Starbucks CEO James L. Donald told *The Seattle Times* he'd know he had been successful in life if employees attended his funeral. In about the time it takes to gulp an espresso, StarbucksGossip.com, a site founded by the chain's employees, had linked to the interview. The baristas massacred Donald. "I'd love to attend his firing," wrote one. "Sounds like he needs a good dose of Turbo Latte," wrote another. "Go to his funeral? Sure, if we get tips."

Where is all this headed? Inevitably, someone will file a business-scene-changing lawsuit. "At some point one of these sites is going to hurt someone very, very big who is not afraid to be emotionally blackmailed," says crisis manager Dezenha. Martin Sorrell, who tried to take advantage of Britain's libel laws, eventually settled. A courageous stand—or a clumsy PR move? And should advertisers start insisting that their ads not appear alongside user-generated venom? The answer may seem obvious. On the other hand, nastiness is quite a draw.

PLAYBOOK: BEST-PRACTICE IDEAS

Managing the Menace of Online Mobs

How to avert a public-relations disaster on the Web

ENGAGE CRITICS

Create a blog so you can strike back quickly. Establish ground rules, and filter nasty, anonymous comments.

BE VIGILANT

Hire a team of media experts to troll for bad news, rumors, and trends. Know what influencers are saying about you at all times.

JUMP IN AND OPEN UP

Address anything that could turn into a bonfire immediately. Replace "no comment" with transparency, candor, and humility.

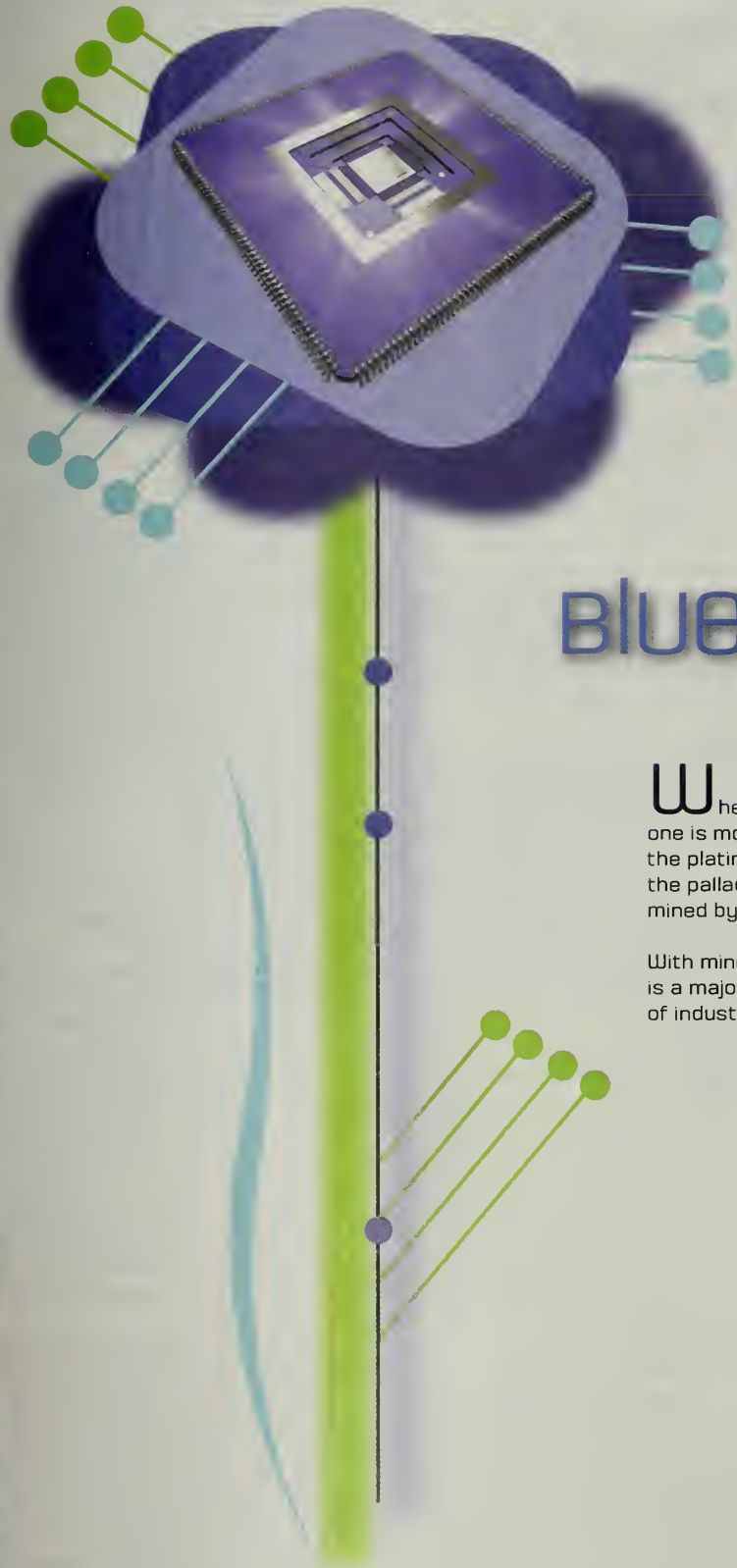
DON'T OVERREACT

Let tiny spasms of venom go. They'll disappear under the relentless pileup of new information.

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The New Alchemy At Sears

It has quietly created \$1.8 billion in securities based on Kenmore, Craftsman, and DieHard

BY ROBERT BERNER

SEARS HOLDINGS CORP. Chairman Edward S. Lampert talks lovingly of his plans to reinvent Sears and Kmart Corp. He makes great theater out of his surprise visits to stores to check out the displays of power tools and the length of the checkout lines. The stock analysts who cover the Hoffman Estates (Ill.) giant follow his lead in counting foot traffic and poring over profit margin data.

But much of the real action at Sears is taking place far from the retail front lines, on a theoretical plane where few have traveled before. Sears is on the cutting edge of a financial innovation so important that it could unlock trillions of dollars in capital across Corporate America and change the way managers of a wide range of businesses think about their balance sheets.

BusinessWeek has learned that Sears has created \$1.8 billion worth of securities based on the brand names Kenmore, Craftsman, and DieHard. In essence, it has transferred ownership of the brands to another entity, which it then pays for the right to use the brands. The deal, carried off last May, was the biggest "securitization" of intellectual property in history, according to Eric Hedman, an analyst at Standard & Poor's, which, like *BusinessWeek*, is a unit of The McGraw-Hill Companies. The story hasn't gotten out until now because the bonds haven't actually changed hands—Sears is holding them in its Bermuda-based insurance subsidiary—and because Sears has never disclosed them, nor has it had to do so. But that could change if Sears were to decide to sell them to outside investors and collect the cash.

Such daring shouldn't come as a surprise at a Lampert-run shop. When he looks at a company, he sees value hidden from plain view—value that traditional accounting methods often miss. That keen eye is what prompted him to buy up a majority of Kmart's bonds at a deep discount after it filed for bankruptcy protection in 2002. He saw that Kmart's real estate was deeply undervalued by creditors, and figured that would protect his investment. He was right.

Now, Sears could be on the cusp of turning a much squishier asset, intellectual property, into actual cash. Don Davis, managing director and general counsel at Commercial Strategy, a Boston intellectual property consulting firm, says the potential for a market in bonds backed by intangible assets could be even bigger than the market for junk bonds, given that 70% to 80% of the total value of the stock market rests on intangibles such as intellectual property.

"The scale is astounding," he says.

But if Sears opens the floodgates for new market, things could get messy. Junk bonds caused plenty of upheaval when the debt market turned ugly in the late 1980s. Sears' brand bonds are worrisome in one sense, say securitization lawyers and accountants: The company has purchased the ownership of its three core brands out of the reach of existing bondholders if the retailer ever ends up in bankruptcy. "Lampert has mortgaged Sears' crown jewels," says Thomas Lys, an accounting professor at Northwestern University. Sears, through a spokesman, says the bonds' only purpose is to provide liquidity in the coffers of the insurance subsidiary to offset any potential losses there. It also says Lampert has nothing to do with the transaction but was briefed on it. And it says Sears' outstanding debt is small relative to the company's total value and is less than the cash it has on hand. Lampert declined to comment.

FROM WHOLE CLOTH

THE JOURNEY TO FIGURE OUT what is going on inside Sears' inner sanctum starts with some footnotes buried deep in financial filings. Sears has disclosed that it has created a "separate, wholly owned, bankruptcy-remote subsidiary"—essentially a company within a company. Called KIP (for Kenmore Craftsman DieHard Intellectual Property), the entity has issued \$1.8 billion worth of bonds backed by the intellectual property of Sears' three biggest brands, according to filings with the Patent & Trademark Office.

Sears has, in essence, created a new income stream from whole cloth. First it transferred ownership of the brand names to KCD. Now, KCD charges Sears royalty fees to license those brands and uses the royalties to pay the interest on the bonds. It then sold the bonds to the insurance subsidiary, where, like any other security on an investor's books, it serves as protection against future loss. The insurer, meanwhile, protects Sears from financial trouble—because it's a subsidiary, it does so at a lower cost than Sears could get from an outside party.

If you're confused, that's because it's all circular: The payments net out to zero because Sears owns every piece. But what would change if Sears were to sell the bonds to outsiders. Then *voilà*, Sears would be holding up to \$1.8 billion in cash, and investors would be holding the bonds.

Intellectual property bonds got their start with an unlikely financier: David Bowie. The rock star floated \$55 million worth in 1997, backed by 300 songs with the interest covered by royalty



...ts from the songs. Since then, some 30
...er deals have been struck. Film studios
... issued bonds backed by future rev-
... streams. Designers such as Bill Blass
... retailers such BCBG Max Azria Group
... have issued bonds backed by outside
... ising fees. And restaurant chains such
... urby's Restaurant Group have issued
... ds against outside franchising fees.
... ears' KCD deal is different in one im-
... ant way: It didn't involve preexisting
... lity payments. The company created

the payments in order to issue the bonds. Richard D. Rudder, a New York lawyer who specializes in securitization of intellectual property and consulted on the KCD deal, says it's the first deal he has seen that hasn't involved cash coming in from the outside. In filings, Sears has suggested it could potentially license the trademarks to other parties—for example, to another company to make a new line of Craftsman products—although it hasn't done so yet. Sears declined to comment beyond what it

has said in those filings.

The KCD bonds have a higher credit rating than Sears' regular bonds. Moody's Investors Service has given KCD an investment-grade rating of Baa2, four rungs better than Sears' junk rating of Ba1. How so? If Sears were to go bankrupt, regular bondholders wouldn't be able to get their hands on the Kenmore, Craftsman, and DieHard trademarks, the company's crown jewels. They would go instead to the insurer. Sears says there is nothing unusual about securi-

tizing assets; many companies, including most of the largest retailers, evaluate alternatives to create value from their brands, real estate, and other assets.

Getting details on the bond offering isn't easy. Moody's issued a detailed report dated May 18, 2006, and a press release with few specifics dated May 19. The detailed report was listed on Alacra.com, a seller of financial research, as recently as Feb. 8, at a cost of \$700. When *BusinessWeek* tried to obtain the report from Moody's, the rating agency said it didn't exist. "No additional information is available," says Moody's spokesman Michael N. Adler. Alacra no longer shows the report on its site. "It was pulled," says Carol Ann Thomas, head of marketing at Alacra. "It is very, very unusual. I only know that from our management."

SETTING A PRECEDENT

MOST COMPANIES that "securitize" assets sell the bonds immediately to get the proceeds. Sears says it created the brand bonds for its Bermuda insurance company to hold in its coffers as protection should the insurer suddenly face trouble. In fact, it says the majority of the insurer's assets are made up of bonds issued by Sears' own subsidiaries. But insurers typically hold investment-grade securities unrelated to their company or their parent. To use the bonds of its own company to meet Bermudan regulatory standards, Sears would have to get special permission from the Bermuda Monetary Authority, says Shelby Weldon, the BMA's director of insurance compliance. As to whether the BMA has ever allowed an insurer to hold a majority of such bonds, "I have never seen it," says Richard J. Irwin, a partner and insurance expert at PricewaterhouseCoopers' Bermuda office. Nor has Andy McComb, president of Bermuda's Allegro Insurance & Risk Management Ltd. The BMA declined comment on Sears. Sears says only that it has obtained all necessary regulatory approvals.

In theory, there are plenty of things Sears could do with its fresh source of capital besides using it to strengthen its insurance subsidiary. Obviously, it could sell them and use the proceeds to pay down debt or buy a company. It could even trade them for the debt of another company—say the revolving credit line of another retailer. "Gap Inc. could wake up one morning and have Eddie Lampert as its lender," says Commercial Strategy's Davis. A takeover could follow. Sears declined to comment on any other potential uses for the capital.

Another possibility is that Sears is holding the bonds because it thinks they will grow in value. Davis calls the process "sea-

Lampert's company is blazing a path for other investors

soning": The bonds will probably increase in value over time if Sears demonstrates steady royalty and lease payments. Sears declined to comment.

'INTEREST IS EXPLODING'

WHATEVER SEARS' PLANS may be, there's no doubt it's blazing a path for other private investors. Eric Hedman, a director in S&P's Structural Finance Group, says "interest [in intellectual property deals] is exploding." Rudder, the attorney, expects much of the rise to be driven by private equity firms seeking cheaper financing for acquisitions. Carlyle Group and its other private equity partners in the Dunkin' Donuts acquisition last year used the method on a \$1.7 billion issue backed by the chain's

brands and actual franchise fees. "What has been done so far is only scratching the surface," says Rudder. Ellen Welsh, S&P's managing director of new assets, agrees that any company with intellectual property could unlock value this way. Adds Ronald S. Borod, a Boston lawyer specializing in intellectual property securitization: "It could become the modern day equivalent of junk bonds."

Robert W. D'Loren, CEO of NexCen Brands Inc., is building a whole business model around the securitization of intellectual property. Since August, using debt proceeds from a public offering, NexCen acquired the Athlete's Foot chain, Bill Blass apparel brand, and the Maggie Moo's a Marble Slab Creamery ice-cream store. D'Loren has already created an entity to hold the brands and issue bonds backed by franchising fees from the sneaker and cream chains, and from Bill Blass licensing fees. The diversity of those fees will enable NexCen to issue lower-cost bonds to pay earlier debts and fund further acquisitions. "We have created a platform to become consistent issuer of intellectual-property-backed bonds," D'Loren says.

So too, it seems, has Sears. There's sign of what the endgame may be. But one thing is certain: With the news of the brand bond out, you can bet others will watch closely—and read the financial footnote to see what Sears might be up to next. ■

Big Deals

Brand bonds could be the next big trend in finance. Here are the biggest trademark and franchise fee deals thus far.

ISSUER	SIZE	YEAR
KCD IP (SEARS)	\$1.8 billion	2006
DUNKIN' BRANDS	\$1.7 billion	2006
ARBY'S	\$290 million	2000
QUIZNOS	\$250 million	2005
GUESS?	\$75 million	2003

Stockman: 'There's Nothing to Hide'

Charges of fraud and conspiracy haven't silenced the last man to run Collins & Aikman

DAVID STOCKMAN MADE NEWS 25 years ago when he shared his candid thoughts on President Ronald Reagan's economic plans with a journalist. Today, Reagan's former budget director is again making headlines: On Mar. 26 a grand jury indicted Stockman on eight counts of securities fraud, conspiracy, and obstruction of justice for allegedly cooking the books at Collins & Aikman Corp., the auto-parts supplier that went bankrupt in 2005. Stockman, 60, became the head of C&A in 2003 after his former private equity firm, Heartland

Industrial Partners, sank \$360 million into the outfit. As brash as ever, Stockman maintains his innocence and contests the allegations. On Apr. 3 he spoke with Associate Editor Matthew Goldstein. Here are excerpts from their discussion.

You've been outspoken since your indictment. Are you concerned that it could be used against you?

There is nothing to hide. My fund and I owned about 40% of C&A stock and took the biggest loss [when it crashed], about \$360 million. During the time of the alleged fraud, we bought an additional \$25 million in stock. Why would we buy fraud shareholders when we were us?

Do you benefit from the advisory fees C&A paid Heartland?

The fees were standard and fully disclosed, and 66% of those fees went to Heartland's investors. When I became CEO of C&A in 2003, nothing changed, except I got to live in a motel next door to headquarters, work 16-hour days for no extra compensation, and shell out millions of my own money to cover things like meals,



travel, and employee Christmas parties the company couldn't afford.

Why are prosecutors going after you?

I still have a naive confidence in American justice and don't believe prosecutors go scalp-hunting. But in the current climate, in which business failure has been criminalized, there is nothing to stop them from misguided prosecutions. Here, they piled up a multitude of hyper-technical business and accounting issues until they got an imaginary conspiracy.

Prosecutors say you boosted earnings by improperly booking payments from one of your suppliers, Joan Fabrics, as rebates. Have prosecutors misconstrued such transactions?

We were losing money on the fabrics we bought from our supplier. So we bargained for price relief via rebates. At the same time we did three tiny deals with Joan Fabrics in which we paid the supplier a few million for each. They generated shareholder value. Now, prosecutors are second-guessing those transactions.

Authorities also claim you told employees to get letters from other suppliers that falsely characterized deals as rebates. Did that happen?

First, I never saw any of these letters until our internal investigation in March, 2005, when we restated about 30 rebates that had been booked in the wrong period. The prosecutors' characterization of these letters as deceptive reflects an accounting dispute run amok.

Some say you ignored concerns about the accounting methods used to justify those rebates. Did you?

I ran the company like a town meeting. But I never received any advice about problems with our accounting prior to the internal investigation. The advice I didn't listen to was to stay out of the miserable auto industry in the first place. That was an investment mistake but hardly a crime.

Would you consider a deal?

No. I intend to vindicate myself and all of the other honorable, hardworking C&A executives who have been tarnished by a group of ill-informed prosecutors gone wild. ■

Health Care for All? Not Quite

But Maine's two-year-old Dirigo system is providing other states with a blueprint and useful lessons

BY CATHERINE ARNST

FOR A GLIMPSE OF WHAT universal health care might look like, come to Maine, the first state to launch a bold experiment in health insurance for all.

More specifically, travel to Warren, a small town a world away from the luxury summer homes of Bar Harbor. That's where Joan Donahue lives. She's a 40-year-old divorced mother of two and a registered nurse who grew up using Medicaid, the federal insurance for the poor. Three years ago she risked her climb into the middle class by cashing in her retirement account and starting a business, Hummingbird Home Care. Donahue couldn't possibly afford health insurance, either for her family or her few employees, and banned her teenage son from risky sports. "One broken bone would have wiped us out," she says.

So Donahue was more than eager to become an early adopter of Maine's grand experiment. Governor John E. Baldacci started lobbying for universal health care on his first day in office in 2002; a year later, the state legislature overwhelmingly passed the Dirigo Health Reform Act. (*Dirigo*, the state motto, is Latin for "I lead.") It went into effect on Jan. 1, 2005, featuring a health insurance plan for individuals and small businesses, with coverage available to all and subsidies based on income.

Baldacci's far-reaching plan aims to cover the uninsured, cut health-care costs, and improve quality all at the same time. But compromises had to be made. To reassure free marketers that this wasn't a Big Brother-like program, enrollment was voluntary. And a funding plan was devised that would have Dirigo

pay its own way by recapturing any savings accrued to the health-care system from covering the uninsured.

With Dirigo's subsidies, Donahue was able to cover her family and offer insurance to her five employees at a cost of \$288.38 per month for each. Three signed up, paying 40% of the premium, and Hummingbird is picking up the rest. The other two, though, found the plan still too costly. And therein lies the problem—even when insurance is subsidized, some people cannot, or will not, pay.

That's just one of the crucial lessons Maine's experiment holds for the many states and Presidential candidates trying to find solutions for covering the 47 million Americans who are uninsured. But the key lesson may be that no matter what the plan, getting to universal coverage will be a problem-strewn slog.

TOO COSTLY?

TWO YEARS AFTER Dirigo went into effect, 13,500 Mainers have enrolled. That's enough to help bring Maine's uninsured rate down from 14.5% pre-Dirigo to 12.5% in 2006, making it the only state to lower its percentage of uninsured over the five-year period. But Baldacci had projected 31,000 enrollees in its first year, with all of Maine's 130,000 uninsured covered by 2009. The shortfall is grist for the plan's enemies, who complain it is too costly and too complicated.

Outside the state, policy experts say criticism of Dirigo can't negate Maine's most significant accomplishment: It is the first state in over a decade to attempt to solve the uninsured crisis. "I give them a lot of credit for being

DONAHUE The entrepreneur has turned activist for Dirigo





the leader. That's very tough," says Karen Davis, president of the Commonwealth Fund, a nonprofit that studies health-care. "You see elements of Maine's [plan] in all of the other state proposals as a result."

Later this year, Massachusetts and Vermont will roll out their own universal coverage initiatives, while the governors of California and Pennsylvania announced sweeping proposals in January. Several more states are trying piecemeal reforms, and last month the National Governors Assn. created a Health Care Working Group to come up with an action plan to support state efforts.

In some ways, Maine's system is more innovative than these proposals; in other ways less so. On the plus side, Dirigo is the

"A broken bone would have wiped us out"

only plan that addresses rising costs. Health spending is an unsustainable 18% of Maine's gross domestic product. Baldacci got the state's hospitals to voluntarily cap price increases at 3% during the first year of the plan; the state also placed

stringent limits on hospital spending.

Health care inflation could doom those plans that duck the issue. "You simply can't have universal access without addressing cost," says Paul B. Ginsburg, president of the Center for Studying Health System Change. "Massachusetts doesn't have any cost containment, and they are either going to have to address this issue very soon or else spend a lot more money to ensure affordable coverage."

But Massachusetts has taken a major step beyond Maine by mandating that all residents get insurance. As Dirigo has proven, voluntary enrollment makes it a lot tougher to get to universal coverage. Even without mandates, however, Dirigo's enrollment has been a bust more in perception than reality. Dirigo Choice is in fact the fastest-growing insurance policy ever offered in Maine. To get 13,500 signups in two years in a sparsely populated, relatively poor state is considered a success in the insurance industry.

The most vociferous complaints about Dirigo are about money—specifically, how much coverage costs and who has to pay for it. The insurance is offered by Anthem Blue Cross & Blue Shield, which already covers more than 80% of Maine's policyholders. Anthem's market dominance gave the state little bargaining power when it came to negotiating premiums,

SHAWN G. HENRY



BENNETT "I just don't see a need to continue pushing this," says the ex-state senator

and lots of Maine's low-income uninsured consider Dirigo still too costly.

As for funding, Dirigo started with a one-time, \$53 million infusion from the state. Ongoing costs are to be met by a controversial annual payment from the state's insurers, including large companies who self-insure their employees. Currently, Maine hospitals have to charge higher prices across the board to make up for the more than \$200 million they incur each year in bad debt and charity care. Dirigo assumes hospital prices will decline as the uninsured get health insurance and rather than have the insurers pocket the difference, the state wants the savings paid back.

Maine's Superintendent of Insurance calculated the savings payback as \$43.7 million for 2005 and \$34.3 million last year, and insurers immediately filed suit, charging those amounts were too high. They have yet to prevail legally, but the offset payments may be too controversial to continue. Baldacci set up a commission last year, with many of

Dirigo's enemies as members, to come up with alternatives. "We've come a long way in four years, and I realize we have to do things differently now," says Baldacci. "But I put my harshest critics at the table to work out a solution. They all live here, and they all want to do the right thing."

Agreeing on the right thing won't be easy. In January the committee recommended new taxes on alcohol, cigarettes, and snack foods to fund Dirigo, riling antitax groups. And in late March, Baldacci suggested the state could save money by ditching Anthem and insuring residents itself, raising cries of "socialized medicine" from conservatives.

Then there are those who think Dirigo is just a lousy plan. Richard A. Bennett, CEO of the Corporate Library in Portland, has 29 employees and views Dirigo as a poor alternative to the "very good set of benefits" he offers now. As a former Republican state senator, Bennett voted against Dirigo. "This has become a very, very expensive commitment," he says. "I

just don't see a need to continue pushing this experiment."

To many of Maine's smallest businesses, it's an experiment that meets their most desperate need. At the recent Maine Fishermen's Forum in Rockport, some 40 people crowded into a seminar to hear about insurance options, far more than attended many other sessions. "It's absolutely the biggest issue facing our members," says Sebastian Belle, director of the Maine Aquaculture Assn.

'WE CAN RELAX A LITTLE'

AQUACULTURE—FISH farming—is a tough business that can easily go a year without any profits. That was the case for Eric Horne and Valy Steverlynck, two of the iconoclastic entrepreneurs that Maine tends to attract. The couple left their corporate jobs in Boston in 1999 to start an oyster farm in Freeport, Eric's hometown. It takes three years to establish an oyster farm, and they couldn't begin to afford the \$1,500-a-month insurance premium Blue Cross would have charged to cover themselves and their two young sons. "I came back because we wanted a lifestyle change, but to be honest, the insurance thing made us question our decision," says Horne. Last year they signed for Dirigo, paying a subsidized \$200 a month. "We can relax a little now."

As for Joan Donahue, she recently got her first physical in years thanks to Dirigo, which pays 100% of preventive care and screening. She also turned into an activist. When opponents escalated their attacks against Dirigo last year, she drove to Augusta and testified before the state legislature, unbidden. "I was pulled by all the negativity from people who already have health insurance," she says. "I don't know how they can tell people like me that Dirigo has failed."

States of Play

Here's how five states' universal health-care plans stack up:

MAINE

- (effective Jan. 1, 2005)
- Enrollment is voluntary
- Includes reforms to contain medical costs
- Initiates a long-term plan to improve health-care quality
- Financed partly with insurers' savings on health-care costs

MASSACHUSETTS

- (July 1, 2007)
- Requires most individuals to buy insurance or pay tax penalties
- Employers contribute to worker coverage, with state subsidies
- Financed by state, federal, employer, and individual contributions

VERMONT

- (Oct. 1, 2007)
- Employers required to contribute to worker health-care costs
- Heavy emphasis on reducing costs of chronic illnesses
- Financed partly with tobacco tax and Medicaid enrollment caps

CALIFORNIA

- (Governor's proposal: January, 2007)
- Individuals must buy insurance, with subsidies offered based on income
- Financed partly with taxes on employers who don't offer coverage
- Hospitals and doctors getting high reimbursements pay in as well

PENNSYLVANIA

- (Governor's proposal: January, 2007)
- Voluntary for everyone except full-time college students
- If ranks of uninsured don't decline, coverage mandates kick in
- Financed through tobacco tax, cuts in "for-profit" hospital charity care

Stopping Reform Before It Starts

Small biz is emerging as a powerful opponent of universal health care

RICHARD S. DUNHAM
AND KEITH EPSTEIN

BIG BUSINESS CEOs ARE lining up left and right in favor of health insurance coverage for all Americans. But there's a big barrier to a sweeping overhaul of the U.S. health-care system: small business.

While activist CEOs of major corporations have changed the debate over health care by entertaining the idea of comprehensive reform and universal coverage, small-business groups remain committed to blocking broad government involvement. And small businesses have a surging amount of political muscle. "When small-business owners feel threatened by government intervention, they rely on their strength," says Karen Kerzner, president of the Small Business & Entrepreneurship Council, a conservative advocacy group. "If any health-care plan imposes government mandates or costs on the small-business sector, it's going to be very difficult to pass."

One of this reflexive resistance is one reason why Charles N. "Chip" Kahn III, president of the Federation of American Hospitals, and Ron Pollack, director of the liberal advocacy group Families USA, urged the National Federation of Independent Business to join secret talks in March to create a bipartisan coalition to push for universal health coverage. The group, the nation's largest small-business organization, with a half-million members, turned them down cold.



NFIB Executive Vice-President Dan Danner says his group steered clear of the talks because it worried the coalition would back government-run health care. Only about 50% of small businesses pay for workers' health insurance, and the

NFIB feared that all of its members would be forced to bail out old-line manufacturers saddled with billions of dollars in legacy costs. "At the end of the day, that's always the rub with these proposals: How are you going to pay for them?" observes Danner. "It's the proverbial whose-ox-gets-gored, who pays for what."

Many small-business owners agonize over health care. Joe Balsarotti, who has owned a computer consulting business in St. Louis since 1983, provided health care for his four employees until the coverage costs quadrupled for one, a diabetic. When that employee left the company, Balsarotti ended the benefit. "It was either that, or cost exceeds profits,"

he says. Balsarotti knows that reform is necessary in health care but worries what kinds of remedies Washington might apply. "I can't run a business if I don't know what my costs are," he says. "I also don't like the idea of a govern-

Q&A WITH ED GILLESPIE

ONE INDICATOR of the changed atmosphere surrounding the health insurance debate is that Ed Gillespie, a former Republican National Committee chairman, is teaming with Big Business to push a larger role for government. Gillespie, a lobbyist, represents such clients as Safeway, Tenet Healthcare, and Bristol-Myers Squibb. Here are excerpts from his Apr. 3 discussion with *BusinessWeek* Senior Writer Richard S. Dunham:

What's changed that has prompted CEOs to push for universal health insurance coverage?

We're getting to the point where one in every five dollars in the economy is spent on health care. The health-care system we have is antiquated and unsustainable. American companies are at a disadvantage in an increasingly global economy. Businesses realize you're either

going to be part of the problem or part of the solution.

While business largely agrees on the problem, isn't there a problem reaching consensus on the best solution?

Big business is split. Some businesses are trying to fix the system. There are some businesses trying to offload costs onto the federal government.

How do you see health-care reform playing out in the next election?

Health-care policy will be the defining domestic policy debate of the 2008 campaign.

Polls show that voters overwhelmingly favor Democrats when it comes to health issues. What should your party do?

Health care as an issue has not been good to Republicans in the past, and we have to be out in front on it. We have to push for access and affordability without destroying the market-based system.



ment bureaucracy running things.”

With small businesses conflicted or opposed to change, big businesses are moving ahead. Even without the NFIB, the Kahn-Pollack talks resulted in a 16-organization coalition for universal insurance coverage. Members include the U.S. Chamber of Commerce, the American Hospital Assn., and America's Health Insurance Plans as well as large companies such as Johnson & Johnson, Kaiser Permanente, and Pfizer.

But even Big Business is divided. The National Association of Manufacturers left the coalition during the secret talks. Says the NAM's CEO, John Engler: “The idea that we're going to trust the government that gave us the Post Office, the Transportation Security Administration, and the IRS is just not likely.”

OPPORTUNITY FOR INPUT

ADVOCATES OF CHANGE realize they can't succeed without persuading small business to join them or remain neutral. Says one business coalition representative: “Small business has a lot of power and helped to kill Bill Clinton's health-care plan” in 1994, when many big businesses were open to government action.

Republican consultant Frank I. Luntz, whose client list includes both large and small businesses, says elected officials see small-business owners as “the American Dream occupation. Politicians want to help them.”

Maybe so, but small businesses also deftly deploy campaign contributions to friendly lawmakers and cooperate to pressure their hometown representatives. Small businesses know “it's crazy not to be actively participating in the debate at this time,” Danner says.

Congressional leaders are giving small-business groups plenty of opportunity for input. The NFIB is working with Senators Max Baucus (D-Mont.), Dick Durbin (D-Ill.), Mike Enzi (R-Wyo.), Olympia J. Snowe (R-Me.), and others to win approval of new health-care tax breaks for small business. And Senator Ron Wyden (D-Ore.) has regularly consulted with the NFIB to get feedback on the group's concerns about his reform plan.

But what small businesses really want,

says Kerrigan, is for Congress to pass series of small measures that would give small businesses more insurance choices and make the system more affordable.

Among the top priorities: allow entrepreneurs to lower their insurance premiums by buying into larger pools of multiple small firms; breaking down regulatory barriers by allowing small businesses to pick insurance offerings in any state, not just in their home base; giving sole proprietors the same kind of health-care tax break that larger employers get; and expanding health savings accounts and giving small employers more tax incentives to offer HSAs to their workers.

Ed Gillespie, a Washington lobbyist who is set to direct a coalition of reformers led by Safeway Inc.'s Steve A. Burd, thinks entrepreneurs can be brought to the table. “Small businesses always have to be leery of mandates,” says Gillespie, a former Republican National Committee chairman. “But they want to be part of the solution, too.”

Small businesses deploy hefty donations to friendly lawmakers

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The Divided States Of America

States and municipalities are responding in wildly different ways to undocumented workers

EAMON JAVERS

GUSTAVO TORRES IS A popular guy these days. As he walks into the storefront worker center he runs, the Hispanic men and women who fill the waiting room wave and call out "buenos días." Torres' nonprofit has been hired by Montgomery County, Md., to provide employment services to these immigrants, about 60% of whom are in the country illegally. The county pays Torres' group, CASA Maryland Inc., about \$700,000 a year to provide hiring halls, English language classes, and legal help in employment disputes. What's more, the county doesn't share what the federal government thinks is a welcoming attitude. "The local government says they are not going to cooperate with [U.S.] Immigration & Customs Enforcement," says Torres.

It's a different world just three hours away in Hazelton, Pa. The local government there is trying to push through ordinances meant to drive illegal immigrants out of town and punish employers who hire them. "Illegal immigration is destroying the quality of life," says Hazelton Mayor Louis J. Barletta.

This stark contrast is repeated again and again across the country, confounding businesses with local rules designed to deal with an undocumented population estimated at 12 million nationwide. The federal government's often haphazard en-



forcement of immigration laws and the absence of a comprehensive immigration policy only adds to the confusion. "This is like a Bermuda Triangle," says Di Ann Sanchez, vice-president of human resources at Dallas/Fort Worth International Airport in Texas.

According to the National Conference of State Legislatures, more than 80 immigration-related laws were enacted in 32 states in 2006; most of those measures were attempts to crack down on illegal

BARLETTA
He says illegals are a detriment

immigrants. Wyoming, for example, enacted a law in 2005 that changed the state's definition of "employee" to mean someone an employer believes to be a citizen or permanent resident at the date of hire. That same year, Kentucky passed a law requiring proof of citizenship to obtain certain professional licenses. In Georgia a 2006 law forces employers to accept only identification from states that don't issue IDs to illegal immigrants, a law that clashes with the federal mandate that employers accept driver's licenses from all 50 states as valid ID. "Which law do you obey?" says Bob Thomas, executive director of the Roofing & Sheet Metal Contractors Association of Georgia.

CAMPAIGN PRESSURE

OTHER AREAS are welcoming immigrants. New Haven, for one, plans to offer a city identification card that undocumented workers may use to access city services. And in addition to the one in Montgomery County, Md., there are 62 sanctioned day-labor centers in 17 states, according to a 2006 study.

Hazelton, Pa., took a different approach last summer when its mayor pushed ordinances intended to crack down on illegal immigration. The city was sued last August by the American Civil Liberties Union and a coalition of local residents and business owners who argued that the city was trampling on the federal government's domain over immigration. The U.S. Chamber of Commerce sided with the ACLU. A judge blocked enforcement of the ordinances while the case is under way.

Meanwhile, many businesses still hold out hope that the new Congress can pass an immigration bill that includes a guest worker program and a path to citizenship for some illegal immigrants. But the politics of the 2008 Presidential campaign will make that difficult, business and political leaders say. If Congress can't pass a bill by the fall, before the campaign begins in earnest, changes likely won't come until 2009. ■

Law and
Disorder
Crazy quilt of
immigration rules
wilders business

GEORGIA

Employers may not accept IDs as proof of work authorization from states that allow illegal aliens to obtain such IDs. Federal law says employers must accept IDs from all 50 states.

COLORADO

State contractors must use the federal government's Basic Pilot worker verification program. Employers complain that the program is not effective.

MONTGOMERY COUNTY, MD.

Provides day-labor centers for immigrant workers, 60% of whom are illegal.

HAZELTON, PA.

Requires employers to prove employees are legal or risk losing business licenses. A federal judge blocked the rule, pending the resolution of a lawsuit.

Big Pharma's Animal Spirits

Sales of medicine for pets and livestock are giving drugmakers a welcome boost

BY ARLENE WEINTRAUB

ORGANON BIOSCIENCES has a bevy of products addressing women's health issues, but that's not the only reason Schering-Plough Corp. on Mar. 12 pledged \$14.4 billion to acquire the Dutch biotech. Organon is also the world's leading maker of vaccines to protect livestock and household pets. What's more, it markets drugs to treat everything from diabetic dogs to cats with cardiac problems. Of the \$5 billion that Organon is expected to add to Schering's top line this year, \$1.5 billion will come from products for four-legged and feathered critters.

As Big Pharma struggles to find new blockbuster drugs for treating human ills, the industry is quietly churning out innovations on the animal side of the business. Livestock pharmaceuticals are booming, thanks to increased farm production fueled by the globalization of agricultural products. And the pet business is even friskier. Eli Lilly & Co. has a brand-new pet-health unit, which released a doggie antidepressant on Apr.

2. Pfizer Inc. is about to launch a drug to help obese dogs shed pounds, and this summer it will introduce a product that can prevent Bowser from getting carsick. Bayer Animal Health has a new injectable chip for tracking lost pets.

Despite the expense—the obesity drug might cost as much as \$2 a dose for a once-daily treatment—pharma companies are likely to find plenty of doting pet owners eager to open their pocketbooks. All told, Americans will spend \$9.9 billion on

medicines to treat their pets this year, 52% more than they spent five years ago, estimates the American Pet Products Manufacturers Assn. “People will pay as much as \$500 per animal just to do a round of vaccines and tests,” points out Schering Chief Executive Fred Hassan. Schering was a stalwart in the veterinary market even before the Organon acquisition.

There are other advantages for companies making dog de-wormers and bovine antibiotics. Animal health is an important hedge against the human side of the business, where drugmakers are facing what analysts call a “generic cliff.” With more than 70 major

mention the pet food industry, which now facing lawsuits over the recent poisonings from contaminated food.

Sales of drugs for livestock and pet have been growing steadily, year after year, often outpacing the growth of drugs designed for people. In 2006 revenue for Pfizer's animal-health business edged up 5%, compared with just 2% growth for its human pharmaceuticals. Units like these “tend to be strong cash generators which adds consistency and visibility to earnings,” as well as contributing to dividends, says David Risinger, an analyst at Merrill Lynch & Co.

HINTS FOR HUMAN CURES

BREAKTHROUGHS in animal health can also help educate scientists who are developing human drugs. On Mar. 26 the Agriculture Dept. granted limited approval of a therapeutic vaccine to treat dogs with skin cancers called melanoma. The drug will be marketed by Merial, an animal-health joint venture of Merck Co. and Sanofi-Aventis. Merial will spend the next year or so collecting data on how



dogs respond to the vaccine so it can ultimately promote the product beyond a limited market of veterinary oncologists. These efforts might complement research many companies into cancer vaccines for humans. “We hope the human side of the industry will benefit from our findings,” says Dr. Robert Nordgren, Merial's vice president for vaccine research.

To understand why the industry is so eager to play in the pet and livestock market, consider one detail buried in Pfizer's 2006 annual report. The company's Advantage line of flea and tick-control products outsold all of its other consumer treatments aside from aspirin and acetaminophen. Not to mention, says Thomas Hopper, director of marketing for Bayer Animal Health, the business taps the primal human-pet connection. Hopper: “It's a feel-good industry.” Feeling good is something Big Pharma has been missing of late. ■



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EDITED BY ADAM ASTON

INNOVATIONS

Of pipsqueak pups and souped-up solar cells

» From towering mastiffs to tiny Chihuahuas, dogs have more variety in size than any other mammals. Now, by studying the DNA of 143 dog breeds, scientists hope to learn more about how people grow. Researchers from the National Human Genome Research Institute have identified a gene variant that gives small-breed dogs their pipsqueak stature. Since humans have the gene, too, the discovery could yield clues to how height is genetically programmed in humans.

» Today's silicon-based solar cells are so mirror-like that lots of the sun's energy is lost when photons are reflected away. But scientists at Georgia Institute of Technology have cut these losses. Using carbon nanotubes, the team grew ultra-tiny

"towers" across the surface of the cell. The structures not only increase the cell's surface area, which boosts the amount of sunlight it can absorb, but also help it to catch more rays by trapping photons that carom into the gaps between the structures. The findings are a step toward making a new kind of solar cell that will be smaller, lighter, and cheaper than today's silicon cells.

—Arlene Weintraub



OPTICS

ADJUST THE WORLD TO THE COLOR YOU WANT

THERE'S A SUNGLASS lens for every activity: amber for skiing, dark gray for the beach, and yellow for driving at dusk. Now scientists are developing "smart" lenses that can display different colors at the flick of a switch.

Of course, glasses that go from transparent when indoors to tinted in bright light are nothing new. The prototype lenses made by a team from University of Washington can show blue, and soon red or green. A knob in the frame activates a

mini battery that sends out a charge. An "electrochromic" polymer in the lens responds by adjusting the level of darkness and color in a second or two. Unlike earlier attempts at technicolor eyewear, which needed a steady flow of current, these lenses need only a pulse to change, so they use less energy. Unveiled at March's American Chemical Society meeting, the color shifting shades could hit the market in a couple of years.

—Aili McConnon

ECO WATCH

CORAL MAY BE TOUGH TO KILL OFF

COLORFUL CORAL REEFS are imperiled by climate change. Already, damage from sewage, fishing, and pollution has led to widespread declines in these complex ecosystems. Rising CO₂ levels are the latest threat. As the gas accumulates in the air, more CO₂ dissolves into seawater. There, it turns into an acid that slowly dissolves corals' outer skeletons. There is hope for some species, though. Israeli researchers tested hard-shelled coral

in water 10 times as acidic as today's oceans—what ocean water may be like in 150 years. Publishing in *Science*, they report that the corals lost their skeletons yet did not die. Instead, they survived as soft-bodied polyps. The findings suggest that while reefs remain at risk, some coral species may avoid extinction, says Maoz Fine, a marine zoologist at Bar-Ilan University.



TREATMENT

HOW A FEMALE HORMONE IMPEDES MS

ONE TANTALIZING observation about multiple sclerosis is that it goes into remission during pregnancy. The degenerative disease occurs when the immune system attacks nerve cells. And it's known that pregnancy hormones such as estriol turn down the mother's immune system to protect the fetus from rejection. So could estriol—a form of estrogen—also be a treatment for the disease in women?

Rhonda Voskuhl, director of the MS program at the University of California at Los Angeles, decided to try. In a small study four years ago she showed that the hormone—available as a pill—brought a dramatic reduction in the brain inflammation that is harmful in MS.

Estriol "may not only help bring the immune system under control," says Patricia A. O'Looney, vice-president for biomedical research at the National Multiple Sclerosis Society, "but it may also stimulate cells to make more myelin," a protective sheath that helps nerves carry signals but that breaks down as MS progresses.

That's why Voskuhl is embarking on a larger, two-year study with previously untreated MS patients to see if estriol's benefits translate into improved health. Even if the hormone proves no better than current treatments, it has two big advantages: It's cheap, and it can be taken orally instead of being injected. Although men aren't part of her estriol study, Voskuhl is researching whether testosterone might have a similar effect in male MS patients.

—John Carey

(TOP TO BOTTOM) TAXI/COLORSTOCK/GETTY IMAGES; MIKE WATSON IMAGES/CORBIS; IMAGE COURTESY OF A. BRIESTEN

PUTTING SUPPLIER

DIVERSITY TO WORK

BEST PRACTICES OF THE TOP ORGANIZATIONS FOR MULTICULTURAL BUSINESS OPPORTUNITIES

PRODUCED AND WRITTEN BY JERRY BOWLES IN ASSOCIATION WITH DIVERSITYBUSINESS.COM



Which companies offer the best business opportunities for minority, women-owned and disabled veterans' enterprises?

EACH YEAR, DIVERSITYBUSINESS.COM, A LEADING MULTICULTURAL BUSINESS RESOURCE PORTAL THAT LINKS LARGE ORGANIZATIONAL BUYERS AND MULTICULTURAL BUSINESS OWNERS, OFFERS MORE THAN 500,000 MINORITY-OWNED, WOMEN-OWNED AND SMALL BUSINESS OWNERS THE CHANCE TO VOTE FOR THE COMPANIES THEY BELIEVE PROVIDE THE BEST SUPPORT TO THE DIVERSITY BUSINESS COMMUNITY. THE WINNING COMPANIES MAKE THE DIVERSITYBUSINESS TOP 50, A LISTING OF THE BEST 50 CORPORATE AND ORGANIZATIONAL BUYERS OF PRODUCTS AND SERVICES FROM BUSINESSES OWNED BY WOMEN, AFRICAN AMERICANS, HISPANICS, ASIANS, NATIVE INDIAN AND OTHER MINORITY GROUPS.

"THE DIVERSITYBUSINESS.COM TOP 50 AWARD IS DIFFERENT FROM ALL THE OTHER RECOGNITION PROGRAMS OUT THERE BECAUSE THE WINNING COMPANIES ARE CHOSEN BY THE DIVERSE BUSINESS OWNERS THEMSELVES," SAYS KENTON CLARKE, FOUNDER AND CEO OF COMPUTER CONSULTING ASSOCIATES INTERNATIONAL INC. (CCAI.COM) OF SOUTHPORT, CT, ONE OF THE COUNTRY'S MOST SUCCESSFUL AFRICAN-AMERICAN OWNED COMPUTER-CONSULTING AND DIVERSITY SPECIALIST FIRMS, WHICH PRODUCES DIVERSITYBUSINESS.COM.

ALTHOUGH EFFECTIVE SUPPLIER DIVERSITY PROGRAMS VARY FROM ORGANIZATION TO ORGANIZATION, CLARKE SAYS, THAT THERE ARE "BEST PRACTICES" THAT TOP 50 COMPANIES TYPICALLY FOLLOW THAT DISTINGUISH THEM FROM LESS SUCCESSFUL PROGRAMS. HERE ARE THREE EXAMPLES FROM TOP 50 COMPANIES:



Kenton Clarke
CEO of Computer
Consulting Associates
International Inc.

1

AT&T BEST PRACTICE: SET CLEAR GOALS AND MEASURE FOR SUCCESS.

AT&T has gone through dramatic changes over the past few years, but one thing that hasn't changed is its support of supplier diversity. For almost four decades, the company voted number 1 in the latest DiversityBusiness.com Top 50 survey has led the telecommunications industry with innovative programs and significant financial goals designed to bring diverse suppliers into its mainstream supply chain. At the new AT&T, which acquired BellSouth Corporation in 2006 and now has consolidated ownership of the former Cingular Wireless, the commitment has been accelerated. In 2006, AT&T bought more than \$5.15 billion in goods and services from diverse businesses, including \$3.1 billion from minority suppliers. This commitment to spending with diverse firms is one of the reasons that AT&T is part of the Billion Dollar Roundtable, a supplier diversity think tank of only 12 companies that spend more than \$1 billion on an annual basis with diverse companies. In the past decade, AT&T has spent more than \$24.5 billion with diverse suppliers, representing 17 percent of the company's total procurement dollars. AT&T Chairman and CEO Edward E. Whitacre Jr. has also pledged to increase the company's spending with diverse suppliers by another \$250 million this year.

"The DiversityBusiness.com Top 50 award is different from all the other recognition programs out there because the winning companies are chosen by the diverse business owners themselves."

Get more out of your partnerships. Now at Dell.

Having a direct relationship with our diverse suppliers helps us deliver our best customer experience. We partner with suppliers to provide innovative services and products, like Dell™ PowerEdge™ servers with the powerful Intel® Xeon® Processor. At Dell, the unique way we've harnessed the Internet, along with our collaborative way of doing business with our partners, allows our suppliers to continue to meet our needs. Success real time. Capture it at Dell.



He recommends
Windows Vista™ Business



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PUTTING SUPPLIER DIVERSITY TO WORK

AT&T plays a leading role within the Telecom Industry Group to produce DiversityNEXT, an annual initiative at TelecomNEXT, the industry's largest trade show and conference, featuring innovative minority-, women- and disabled veteran-owned businesses and suppliers in the telecommunications industry, along with cutting edge diversity solutions that OEMs, service and content providers have developed. Maureen Merkle, president-Procurement, AT&T, was a keynote speaker for this event in 2006.

In another new initiative, AT&T recently worked with BIZPHYX, Inc., a leading quality and TL 9000 solutions provider, to deliver web-based training on ISO 9001 and TL 9000 to minority-, women- and disabled veteran-owned businesses. BIZPHYX is a WBENC (Women's Business Enterprise National Council) registered company.

"One of the key best practices is establishing an ambitious numerical diversity goal," says Joan Kerr, executive director of AT&T Supplier Diversity Programs. "That's critical to success. Corporations perform best when given clear supplier diversity metrics to achieve, and the management team regularly reviews performance against those metrics. We have a numerical goal to procure 21.5 percent of our external spend with diverse suppliers each year, and that keeps everyone focused on including diverse suppliers in our procurement processes so that we can achieve that target."



2 DELL BEST PRACTICE: MAKE SUPPLIER DIVERSITY A BUSINESS IMPERATIVE THAT IS VISIBLY SUPPORTED AT THE CEO LEVEL WITH CLEAR SENIOR MANAGEMENT BUY-IN.

At Dell, the number 2 company on DiversityBusiness.com's list of top 50 organizations for Multicultural Business Opportunities, year-over-year spending with minority and women business entrepreneurs continues to grow at a 20 percent rate, faster than Dell's non-diverse spend growth. Ying McGuire, senior manager—Dell Supplier Diversity, attributes the program's success in large measure to senior management support.

"Our mission is to deliver shareholder value, enhance the customer experience and drive superior supply chain performance through highly-qualified minority, women-owned and small business suppliers," says Dave F. Brown, vice president for Worldwide Procurement at Dell.

"Supplier diversity is integrated into corporate strategic plans for growth at Dell," McGuire says. "Each executive on the chief procurement officer's staff has a fiscal year target for diverse spend. Commodity managers are accountable for meeting and exceeding the target. There is a realization throughout the company that diverse supplier development is an investment in our future. The suppliers are also current and future customers of Dell."

Dell has a number of active outreach programs designed to make it easier for diverse-owned businesses to work with the company and gain access to near-term procurement opportunities. For example, one program called Coach/Quarterback Training Camp, developed in collaboration with the Central & South Texas Minority Business Council, allows corporate members to coach MBEs to improve their ability to compete for corporate contracts.

In January 2007, Dell held its first-ever Annual Supplier Diversity Summit designed to create a "multiplier effect" by creating new channels and networks to grow diverse spend for Dell and its premier customers. The Summit featured about 200 supplier corporate customers, and Dell purchasing agents.

In mid-year, Dell is planning to launch Direct Talk, a forum held periodically on Dell campus for qualified diverse suppliers to learn about real Dell procurement opportunities on the horizon and have direct dialogues with Dell commodity managers.

3 GM BEST PRACTICE: IDENTIFY AND MENTOR THE "BEST OF THE BEST" DIVERSE SUPPLIERS.

No company in America has supported supplier diversity longer or more consistently than General Motors. Since it launched its formal program in 1968, GM has spent more than \$60 billion with minority suppliers and is the auto industry's largest purchaser of minority-produced goods and services. In 2005, GM continued to demonstrate its commitment to minority supplier development by procuring more than \$5.6 billion in goods and services from direct and indirect minority suppliers (2006 figures not yet available). In the United States, Tier 1 spending accounted for \$3.6 billion and Tier 2 spending totaled \$2.0 billion. While GM has actively supported women business owners, in 2007 it will formally track the business it does with these companies.

GM established its Supplier Diversity Council in 2001. The council is made up of seven GM executives and seven minority and women-owned business executives and meets four times a year. The council is led by Bo Andersson, group vice president of GM's global purchasing and supply chain organization; Jimmy McDonough, executive director, global purchasing - powertrain components and raw materials; and Frank Venegas, Jr., chairman and chief executive officer of The Ideal Group (Detroit, Michigan). The council represents the entire GM minority supplier community and acts as a GM ambassador to diverse markets.

It's not just good.
It's good business.

We're committed to supplier diversity.
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and others. We're proud of that
recognition and even prouder of the
performance of our diverse suppliers.
They've made us a better corporate
citizen and a better company.



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PUTTING SUPPLIER DIVERSITY TO WORK

One of GM's most ambitious and successful initiatives is its mentoring program. Established in 1992, this program has teamed more than 30 of its certified minority and women-owned enterprises with a GM purchasing executive as its champion. The mentor helps the supplier develop a long-range growth plan and arranges for it to get the resources it needs in managerial, quality, technical support and other areas. The mentored suppliers are selected by GM purchasing executives.

"This program has paid off enormously for GM," says V. Diane Freeman, Senior Manager, GM Supplier Diversity. "All our suppliers, minority or majority, compete for business on the same footing. Mentored suppliers are extremely competitive in critical areas such as quality, delivery and cost. They truly provide GM with a competitive advantage."

The recognition that a diverse supply chain is good for business is a common theme across all DiversityBusiness.com Top 50 compa-

nies. There is also the sense that there is a lot more to the story than just "social responsibility."

"In this era of business consolidation, the notion of social good is always trumped by survival," says Kenton Clarke. "Diverse suppliers have shown that they can compete on an equal footing or price, performance and quality. In fact, the Wall Street Journal reported last year that a Hackett Group survey shows that companies that "focus heavily on supplier diversity" generate a 133 percent greater return on procurement investments than the typical business. That's very compelling."

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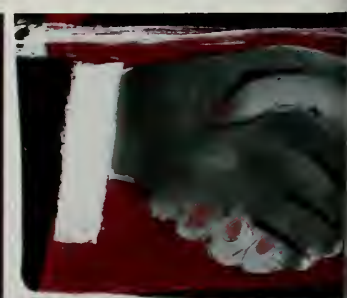
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AMERICA'S TOP ORGANIZATIONS FOR MULTICULTURAL BUSINESS OPPORTUNITIES—2006

1	AT&T INC.	19	SPRINT NEXTEL CORPORATION	34	CORPORATE EXPRESS
2	DELL	19	HOME DEPOT, INC.	35	WELLS FARGO & COMPANY
3	WAL-MART STORES, INC.	20	JOHNSON & JOHNSON	36	EXXON MOBIL
4	LOCKHEED MARTIN	20	WALT DISNEY COMPANY	37	MERRILL LYNCH & CO. INC.
5	BELLSOUTH CORPORATION	21	FORD MOTOR COMPANY	38	COMCAST CORPORATION
6	BANK OF AMERICA	22	CISCO SYSTEMS, INC.	39	PROGRESS ENERGY INC.
7	PROCTER & GAMBLE	23	OFFICEMAX	40	PITNEY BOWES
8	THE COCA-COLA COMPANY	24	PEPSICO INC.	41	PFIZER INC.
9	TIME WARNER INC.	25	AMERICAN EXPRESS	42	STAPLES INC.
10	RAYTHEON COMPANY	26	NORTHROP GRUMMAN CORPORATION	42	UNITED TECHNOLOGIES CORPORATION
11	OFFICE DEPOT INC.	27	CHEVRON	43	NIKE
12	IBM	27	STARBUCKS CORPORATION	44	FANNIE MAE
13	TOYOTA	28	JCPENNEY COMPANY INC.	45	FREDDIE MAC
13	GENERAL MILLS	29	VERIZON/VERIZON WIRELESS	46	AFLAC INCORPORATED
14	XEROX CORPORATION	30	GENERAL ELECTRIC COMPANY	47	WASTE MANAGEMENT
15	UPS	31	ALTRIA GROUP	48	MCDONALD'S CORPORATION
16	DAIMLERCHRYSLER	31	MAJOR LEAGUE BASEBALL	49	TARGET CORPORATION
17	BOEING COMPANY	32	MICROSOFT CORPORATION	50	UNISYS CORPORATION
18	GENERAL MOTORS CORPORATION	33	BRISTOL-MYERS SQUIBB CO.		

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GM thanks our suppliers and diversity council members, as well as our diverse and small business suppliers who have been, and continue to be, part of our success. Diversity is in our DNA.

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Déjà Vu: A Boy's Vacation in France

The author never forgot his trip to the Côte d'Azur. Now his sons have those memories, too. **BY ERIC SCHINE**



THE CÔTE D'AZUR conjures images of celebrities sunning themselves on immense yachts. Yet it's also a great place for a family vacation. I was lucky enough to find that out early on. When I was 5, my parents took my sister and me on the most fabulous trip of my life. We crossed the Atlantic on a French ocean liner and sped to the south of France on a sleeper train. There, we spent three idyllic weeks in the little seaside village of Agay, nestled on a picturesque cove at the foot of ragged red peaks, 19 miles west of Cannes. The memory of that summer has always pulled at my heartstrings. We ate fresh raspberries on the patio of our cozy hotel, went paddle-boating in the clear Mediterranean waters, and explored ruins in the craggy hills. I marched back from town with a baguette under one arm and a *Tintin* comic book under the other, forever transformed into a Francophile. For years, I dreamed of returning to Agay, and when our youngest son, Nicholas, turned 5, my wife, Julie, and I and our two boys set out to recreate that magical trip over two summers. In 2005 we made the transatlantic crossing on the Queen Mary 2 (BW—Oct. 3, 2005). The next year, we flew to Paris for a night train to Agay.

Would I find the sleepy, quiet Southern France of my youth? Not exactly, but Agay had changed less than I feared. We spent our mornings on scenic beaches. Our afternoons were filled with museum visits, hikes, and mini-golf. Along the way, Nick and his 9-year-old brother, Charlie, learned a bit of French: “*Merci!*,” “*A bientôt!*” And they fast discovered the seductions of a good French meal. “*Encore de la bouillabaisse, s’il vous plaît!*”

The instant we boarded our night train at Paris’ Gare d’Austerlitz, the boys were hooked. Sure, we could have taken a much faster, less expensive TGV train during the day, zipping down to the coast

in 4½ hours. But sitting in airplane-like seats held no appeal compared with the romance of pulling out of the station at dusk in our cozy quarters. A first-class cabin (about \$200 round-trip per person) is perfect for a family of four. Not fancy, just clean bunks with sheep blankets, and pillows.

We woke up in a world bathed in brilliant sunlight. Le Relais D’Agay was a place I had remembered it: Shady trees, dappled golden sunlight over patio tables. Our adjoining rooms were tiny (\$134 per night for both), but they opened onto a garden. Before lunch, we took a swim, marveling at the red rock Massif de l’Estérel mountains looming behind the hotel. We knew the water would be chilly in June, so had packed wet suits for the boys.

SPOOKY DUNGEON

WE DIDN’T HAVE TO GO far for exceptional dining. Half of the hotel patio was given over to Côté Jardin, a top destination for locals, who descend in throngs for such Provençal specialties as *tourade à la sardine* on the \$42 prix fixe menu. Nick wasn’t ready for that. Instead,

LESS (clockwise
left): Le Relais
y, with its
lar restaurant,
ôté Jardin;
las Schine, 6,
e beach at Agay;
le Schine, 9, digs
rovençal cuisine



dieval town lovingly maintained with flower boxes bursting with bougainvillea, and with a Romanesque church tower rising amid the tightly packed houses. We climbed the twisting streets to the ruins and spooky dungeon of an ancient castle at the top of the village.

Still in search of the more pastoral Côte

d'Azur of my youth, we boarded a ferry for the 15-minute hop to the island of Porquerolles. With no cars on the island, we felt transported back in time. We stayed on the village square at Villa Sainte Anne (\$254 per room, including dinner and breakfast), with its charming but simple 19th century dining room. A few hundred yards out of town, the island reveals its beauty: rolling vineyards on one side and enchanting coves on the other. We pedaled our rented bicycles a few miles on a sandy lane to Plage Notre Dame, where we spent the

morning beachcombing and swimming.

On our way back from the beach, we visited one of the several forts built from the 16th century onward to fend off Barbary pirates, and later, invading Spanish and British navies. One houses a small exhibit filled with cannons and local lore, including the boys' favorite, a skull with a coin lodged in its mouth found in a nearby Roman burial ground.

The finale of our trip was an excursion to the remote island of Port Cros, a rugged place with no roads but excellent hiking trails and France's only underwater national park. After an hour of hiking, we picnicked on the beach, then Charlie and I donned snorkeling gear. The water was cold and there were jellyfish, but the scene before us was spectacular: brightly colored fish amid dancing sea grass.

The next evening, stretched out on our bunks on the train back to Paris, we talked about the trip late into the night. We haven't stopped talking since. Just recently, before drifting off to sleep, Nicholas murmured: "I miss the Relais D'Agay." I had been missing it for decades. Now we can all miss Southern France together. ■

ered juicy *steak haché* and *frites* from \$13 kids' menu. Whatever you call it, I was happy to see his burger and fries served amid all the strange aromas and hints of French cuisine. Charlie, more adventuresome *à table*, devoured a bowl of *soupe de poissons*. For dessert, the boys ordered *profiteroles*—scoops of vanilla ice cream in pastry puffs, covered with warm chocolate sauce.

Working off such meals was no problem. The local hills are sprinkled with ancient villages, perfect for exploring. One day, we checked out Grimaud, a me-



BY MIKE MARRONE

Groundbreakers From Two Originals

ALTHOUGH CONSIDERED A CULT ARTIST in some circles, Tori Amos has sold in excess of 15 million albums. That may be because fans of this 43-year-old singer/songwriter are fanatical, but there is clearly something else going on. Amos is one hell of a pianist. Granted a full scholarship to the prestigious Peabody Institute of Music in Baltimore when she was just 5 years old, she was asked to leave at 11 because, she has said, she refused to play from sheet music.

Always pushing the envelope, Amos has unveiled five "characters" to be her "voices" in the 23 new songs on *American Doll Posse*, her ninth studio album, set for release May 1. Listed in the liner notes as Tori, Pip, Clyde, Isabel, and Santa, each has a distinctive delivery and vibe, and each unmistakably conveys an individual slice of this performer. Pip represents "dark energy," for example, while Santa sings about passion.

Isabel, whom Amos describes as "historical," sings *Yo George*, a 90-second anti-Bush ditty that is the first cut on the CD. Isabel delivers a much more melodic expansion on political themes later with the exquisite *Dark Side of the Sun*. But that's just a small part of the album's sonic palette. Songs like the ethereal *Girl Disappearing* and *Bouncing Off Clouds*, the deceptively playful pop of *Secret Spell*, and the sinewy *Code Red* had me hooked from the first listen.

They all display Amos' wonderful sense of melody and exceptional instrumental prowess. The pianist extraordinaire relies mainly on her trusty Bösendorfer and ex-



AMOS

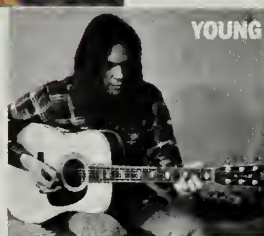
TORI AMOS
American Doll Posse
EPIC
.....
NEIL YOUNG
Live at Massey Hall 1971
EPIC

pands her keyboard arsenal with a Fender Rhodes, an acoustic upright, an electric piano, a Wurli, a clavichord, and a Mello-tron. She is again backed by the sublime rhythm section of Matt Chamberlain (drums) and Jon Evans (bass), with Mac Aladdin contributing acoustic and electric guitar on most tracks.

IT TOOK 36 YEARS, but we finally have the official release of one of the most sought-after and beloved bootlegs of all time: Neil Young's 1971 concert at Toronto's Massey Hall. Because of the pristine recording of the original masters, the sound quality is simply glorious.

This is what Young planned to release as a follow-up to 1970's groundbreaking *After the Gold Rush*. Instead, he went to Nashville for some recording sessions and liked the results so much, he started working on the album that would become the country-inflected *Harvest*, a classic itself.

The Massey Hall concert is Neil Young alone on stage with a guitar, a piano, and his stories. You find out for whom he wrote *Old Man* and hear him explain that he's going to do mostly new songs because "I've written so many new ones that I can't think of anything else to do with them but sing them." He then proceeds to play what have since become standard.



YOUNG

Make sure to get the special CD/DVD combo pack. The DVD includes video of the show, a photo at the Neil Young Archives and more. This second long-promised release from that trove makes yearn for more. ■

Mike Marrone is program director of XM Satellite Radio's *The Loft*, a channel that focuses on an eclectic mix of singer-songwriters from the 1960s to today.



BY ROBERT PARKER

Bordeaux That Will Age Gracefully

RECENT TASTINGS OF Bordeaux's 2003 vintage, the quality of the best wines has been spectacular. And wine lovers have taken note. In fact, now may be the last call for these sumptuous wines before prices really climb out of sight. (The prices listed below are for a 750-ml. bottle and are based on a daily survey of wine merchants by WineAlert.) Here are some terrific 2003s that should age well for two decades or more.

Chart-Milon
97 points. The 2003 may be the finest Chart-Milon...ever! A blend of 73% merlot sauvignon and 27% merlot, it has deep ruby/purple hue in addition to a big, wet perfume of black fruits interwoven with roasted herbs and meat juice. Full-bodied, dense, and well-structured, this stunning cuvée is best consumed from 2010 to 2030. \$45-\$86

Chiando-Mallet
97 points. This is a spectacularly concentrated, inky-blue/purple-colored wine with a marvelous nose of blackberries, raspberries, and a hint of lead-pencil shavings. The wine is powerful, extremely full-bodied, and quite tannic. It needs five to six years of bottle-aging, but it should still be good for 30-plus years. \$46-\$84

Château Ducru
97 points. The wine boasts a saturated plum/purple color as well as a remarkably complex bouquet of black currants, blackberries, espresso, white chocolate, minerals, and truffles. It displays amazing freshness and definition for such a complex, complete, and full-bodied wine. Its low acidity and huge, extravagant forwardness should keep it drinking well for many years. \$80-\$100

Château Poyferré
97 points. I have had this wine three times, rating it 97 once and 98 twice. It is a colossal class and a potential legend in the making. It has a saturated, dense inky-blue/purple color

offers notes of crushed rocks, acacia flowers, blueberries, black raspberries, and crème de cassis. A synthesis of power and elegance, this multilayered wine has spectacular concentration, sweet but high tannin, and low acidity. Anticipated maturity: 2009-30. \$120-\$208

Ducru Beaucaillou
96 points. A blend of 80% cabernet sauvignon and 20% merlot, this is a powerful, tannic blockbuster revealing a mineral component mixed with crème de cassis, raspberry, and flower characteristics. There's also an atypically high 13.5% alcohol level. It is a wine for patient connoisseurs.

Anticipated maturity: 2010-25 and beyond. \$125-\$187

Montrose
97+ points. The enormous 2003 boasts a dense black/purple hue and a wonderful bouquet of scorched earth, blackberries, and cassis, fabulous purity, plenty of texture, and substantial tannin in the finish. This superb wine is one of the vintage's most prodigious offerings. However, patience is essential. Anticipated maturity: 2010-35. \$170-\$189



Robert Parker is the world's most influential wine critic. Visit eRobertParker.com to see tens of thousands of tasting notes, buy his books, or subscribe to his newsletter, The Wine Advocate.

Wines rated from 96-100 are extraordinary; 90-95, excellent; 80-89, above average to very good. For more Parker picks, go to businessweek.com/extras.

Does Your Marriage

Postnuptial agreements can help ease tension as couples' fortunes change—

ROMANCE MUST OFTEN DEFER to pragmatism in marriage, given how fraught an intimate partnership can be. How else do you explain the prenuptial agreement? Now for couples who have already tied the knot there is another way to make explicit the financial (and other) terms of your union: the postnup. ¶ These contracts are a way to sort out money problems when, for any number of reasons (inheritances, business failures, business successes, winning the lottery, quitting work), there is more or less of it than there used to be. It has become a popular way to deal with the conflicting obligations that arise in blended families. ¶ It's possible to think of such an agreement as part of more conventional financial or estate planning.

Or as a blueprint, created in calmer times, for an eventual divorce settlement. It can also be used, though most lawyers don't recommend doing so, to solve the everyday tensions of married life: how often to visit the in-laws or take vacations or do household chores. "People can use this process very flexibly for all kinds of purposes, to revive a marriage or steer it in a different direction," says John Fiske, a Cambridge (Mass.) attorney and family mediator. "You can use postnups to force your marriage to work."

Fiske, who has been writing these contracts for the past eight years and is one of their biggest proponents, has experience with all kinds of, shall we say, creative clauses. One husband gave his wife \$100,000 (tax-free) to acknowledge her worth. Another couple agreed to split up their considerable estate, which was all in the husband's name, and allow each to invest, spend, or give it away as they wished. If they divorce, each keeps what they have. When it came to one business in particular, the wife proposed that her husband receive more than half because he had worked extremely hard to build it up. He was so appreciative that he decided to pay her \$50,000 in "marital alimony" every year on her birthday.

Arlene G. Dubin, a New York attorney and author of *Prenups for Lovers*, suggests thinking about postnups as a way to "take the law into your own hands," especially

The Brief

Unlike prenuptial agreements, for which there is a legal standard, postnuptials exist in uncharted territory.

- To be valid, there has to be full financial disclosure
- Both husband and wife have to be represented by separate attorneys
- Because it is legally sensitive, the postnup should be a clear and concise document
- Lawyers charge about \$400 an hour, and it usually takes less than 10 hours to draft a contract

when it comes to estate planning. There are other ways to interpret her direction, though. "People ask for bad boy/bad girl clauses: If the husband or wife has an affair, drinks, smokes, gains weight, they get more or less money during the marriage," she says. "I try to discourage that. These are unenforceable. People should talk about these issues. But they should put their agreements in a letter, not in a legal document."

Postnups, like prenups, aren't every-

body's idea of problem solving. Skep say even mentioning a marital contract asking for trouble. "How do you sit down with your spouse and say, 'I just got a nus and I'd like to keep it all. Can we s an agreement?'" says Sharyn T. Sol a divorce attorney. "Who's going to good about that? It's kind of tacky."

For some of those in enough distri to contemplate divorce, though, a c tract that resolves specific disagreeeme can do wonders. Janice and Tom (both pseudonyms) had been married for three decades when, in 2000, trouble crept into their relationship. Tom's consulting business was faltering, and he fell into a depression, for which he sought therapy and took medication. They refinanced their home three months before they could have paid off the mortgage. Tom incurred credit-card debt to keep his business going and to pay his share of the household expenses (including their daughter's college tuition).

Janice, a professional whose income had always exceeded her husband's, worried about losing their home. They fought all the time. "We were both scared and mad at each other," says Tom. "We were in a death spiral. It was nightmarish." Says Janice: "My security was being eroded. But I wanted to divorce his financial problems, not him."

A TURNAROUND

IN THE SPRING of 2006, they sought out an attorney who had written postnuptial contracts before. He asked what each wanted: Janice said she expected a reasonable amount of financial se-

ed a Postnup?

them out of divorce court. **BY SUSAN BERFIELD**

ty; Tom needed emotional support. His lawyer suggested they give Janice ownership of the house, a change she didn't know was possible. The other details of their financial life would remain mostly the same.

When they each consulted their own lawyers, Tom's was skeptical: What if she got their home and kicked him out? "I thought I should give it to her because it really was my problem that

caused this," Tom recalls saying. His lawyer replied: "In a divorce court, it wouldn't be." But Tom went ahead. "When we signed the house over to her, everything turned around," he says. "It was the best thing I ever did." Janice says: "Now I'm happy to see him. I feel freed up. It was a tough experience, but exhilarating."

Couples often become enthusiastic about postnuptial agreements after con-

templating the unpleasant economic realities of divorce. Louise (a pseudonym) and her husband, a businessman, also are contending with financial problems serious enough to tear apart their 30-year marriage. Money quarrels that had been frustrating before turned troubling in January. She puts it bluntly: "My husband and I totally don't agree at all about money.... The sh-t hit the fan when he had a breakdown, spent a lot, took from our savings to pay off his credit-card bills, and ended up in the hospital [for psychological treatment]. I said 'If you want to stay married, you have to find a way to make me feel safe.'"

At the suggestion of their marriage counselor, they recently spoke to a lawyer about a postnup. They're negotiating both a marriage contract and a divorce settlement. "Hopefully, we'll be able to work out a marriage," Louise says. "I really think this is revolutionary. I feel buoyed. But talk to me again in two months." ■





ASIA SKYWARD
Hong Kong's
Exchange Square

Hot Properties, Half a World Away

U.S. property is cooling, but foreign real estate funds and stocks are booming. **BY LEWIS BRAHAM**

THE RUNUP IN REAL estate stocks has stalled in the U.S. under the weight of subprime lending woes and a fully priced commercial sector. But overseas, these stocks are kicking into high gear. Indeed, the number of non-U.S. real estate stocks grew from 170 to 314 from 2002 through 2006 in response to strong economic growth, especially in Asia.

This international boom also springs from regulatory and market changes. In recent years, 20 countries have adopted the real estate investment trust (REIT) structure familiar in the U.S., allowing real estate companies that go public to avoid taxes as long as they pay out most of their earnings as dividends. In addition, more developers are going public. By accessing the capital markets, these companies can

do more building, acquire choice properties, and ramp up earnings growth.

Clark Winter, global chief strategist of Citigroup Global Wealth Management, thinks the outlook for global real estate makes it the best among 32 domestic and international asset classes (BW—Mar. 26)

Alpine manager Sam Lieber's list of favorites is Brazil, which is experiencing a residential development boom. "Eight months ago there were only three public traded Brazilian real estate companies," he says. "Now there are 16 and more the way." One of his holdings is home builder Rodobens Negócios Imobiliários. "It builds in small towns where land is cheaper than in the cities," he says.

Other managers think Asia is the place to be. Some 43% of the assets in the Cohen & Steers International Realty Fund are there, and its newly launched companion, Cohen & Steers Asia Pacific Realty Shares, is devoted solely to the continent. C&S Global Chief Investment Officer Joseph Harvey thinks Japanese real estate has the potential for a major recovery after 15 years of declines and that China continues to be a growth dynamo.

Mutual funds aren't the only option. The new SPDR DJ Wilshire International

"What's happening around the world is like the REIT market in the 1990s, heading into a period of rapid growth," he says.

BRAZILIAN BETS

WINTER SAYS low, stable interest rates in Asia and Latin America have led developers to build in places they've avoided in the past. The stability has also made mortgages more available and less costly.

The simplest way to invest in the global real estate market is through specialty mutual funds. The Alpine International Real Estate Equity Fund is by far the oldest, with a 10.3% annual total return since its inception and a 28.9% turn over the past five years through Mar. 31. High

Far-Flung Realty Funds

FUND/SYMBOL	TOTAL RETURN*
Alpine International Real Estate Equity EGLRX	7.76%
Cohen & Steers International Realty A IRFAX	6.87
Fidelity International Real Estate FIREX	4.65
ING Clarion Global Real Estate Income IGR	4.51**
RMR Asia Pacific Real Estate RAP	13.11**
SPDR DJ Wilshire International Real Estate RWX	7.08

*Through Mar. 31. Appreciation plus reinvestment of dividends and capital gains before taxes.

**Closed-end fund portfolio return. Market returns: -10.9% (IGR) and 13.11% (RAP). Data: Morningstar

Real Estate exchange-traded fund carries a low 0.60% expense ratio, less than any competitor's. And a collection of closed-end funds focus on this area, compared to the multitude of U.S. REITs. But given the recent real estate market overseas, more to play will be coming soon. ■

Funds for the Dividend Junkie

timble new offerings grab the equivalent of six payouts a year. **BY AARON PRESSMAN**

INVEST IN A PORTFOLIO of dividend-paying stocks, and you can expect four dividends a year from each. Put your money in one of the new, so-called dividend capture funds, and you get the equivalent of six dividends a year. With projected yields of 10%, it's no wonder you're a hit. Four such closed-end funds totaling \$12.8 billion have launched in the last four months, and five more are in line to go public.

Financial experts say these funds are a good idea, though the returns are likely to be more volatile than those of bond funds. "As long as people are aware of the risks, it's a perfectly valid investment," says Robert N. Gordon, president of Twenty-First Securities in New York. Adds Roger Nusbaum, a money manager at Your Source Financial in Prescott, Ariz.: "Used in moderation, these are a great tool for a diversified portfolio." Nusbaum uses them in the income-producing parts of clients' portfolios alongside funds that invest in real estate and those that boost yield by selling call options.

Although these closed-end funds are new, institutional investors have successfully plied the dividend-capture strategy for years. The idea is to maximize income by trading stocks and their dividend payments. The funds hold the stocks for only 61 days, just long enough to qualify for the 15% minimum tax rate on dividends. (They typi-



Capturing Companies' Dividends

Funds In Operation

FUND/SYMBOL

Alpine Total Dynamic Dividend AOD

Eaton Vance Tax-Managed Diversified Equity Income ETY

Eaton Vance Tax-Managed Global Diversified Equity Income EXG

Evergreen Global Dividend Opportunity EOD

Funds In Registration

Advent/Claymore Global Convertible Securities & Income n/a

Alpine Global Premier Properties AWP

Cohen & Steers Enhanced Closed-End Opportunity n/a

Eaton Vance Tax-Managed Int'l Diversified Equity Income n/a

Seligman LaSalle International Real Estate n/a

Data: SEC filings

n/a=not available

cally buy in advance and sell right after the dividend is paid.) By rotating among stocks, they collect six dividends instead of just four in any 12-month period. The funds also seek companies issuing special one-time dividends.

SCOURING THE GLOBE

THE \$4 BILLION Alpine Total Dynamic Dividend Fund, run by Alpine Woods Capital Investors in Purchase, N.Y., is the most straightforward of the new offerings. The fund seeks stocks from all over the world with high and increasing dividends. Although the new closed-end fund has been in operation for less than two months, it announced distributions of 18¢ a share for March, April, and May. That's an annualized yield of 10.3%, at the fund's current share price of \$21.

One of the newer funds, the \$5.5 billion Eaton Vance Tax-Managed Global Diversified Equity Income Fund, invests in a mix of U.S. and foreign stocks with an emphasis on high-dividend payers. To boost the yield even more, the fund also sells call options on the Standard & Poor's 500-stock index and some foreign stock indexes. The gains on the options are partially offset by occasional losses on the stocks, which sometimes fall in price after the dividend.

Boston-based Eaton Vance's \$2.6 billion Tax-Managed Diversified Equity Income Fund, launched last November, uses the same strategy, though the older fund invests only in U.S. stocks. That fund has already paid one quarterly dividend of 46.25¢, an annualized yield of more than 9%.

The dividend hunt demands more trading than a buy-and-hold portfolio, yet the management fees are lower than those on the average equity mutual fund. There are, however, less obvious commissions and related trading costs. They're not spelled out like management fees, but they take away from the total returns.

As tempting as the new funds may be, think twice before buying a closed-end fund at an initial public offering. From the get-go, they're always selling at a premium to their net asset value, because underwriting fees and commissions are baked into the share price. Most closed-end funds soon lose that premium. Given the busy calendar of offerings, it's a good bet most will be selling at discounts by the fourth quarter. Better to do your shopping then. ■



BY GENE G. MARCIAL

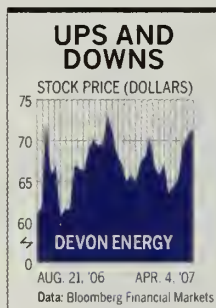
DEVON ENERGY'S VAST OIL RESERVES MAY CATCH EXXON'S EYE.

A CODE-FREE SECURITY SYSTEM COULD UNLOCK NAPCO STOCK.

SYNGENTA IS GROWING TALL ALONG WITH BIGGER CORN CROPS

Will Exxon Go for Devon?

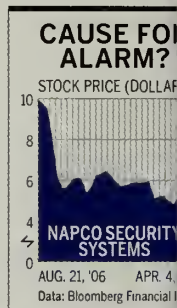
EXPECT MORE MERGERS and acquisitions in the oil patch. As oil companies pump up their cash hoards at a dizzying pace, they are looking for growth in the U.S. rather than overseas, says Michael Metz, chief investment strategist at Oppenheimer. Russia, Venezuela, and other Latin American countries are now less welcoming to U.S. oil interests, notes Metz, so Big Oil is looking for American outfits with outsize reserves. Oppenheimer oil guru Fadel Gheit says rumors have resurfaced that Exxon Mobil may go after Devon Energy (DVN), a major oil-and-gas company and the largest U.S.-based independent natural gas producer, with an estimated proved reserves of 2.4 billion barrels of oil equivalents. "An Exxon-Devon deal makes sense," says Gheit, because of Devon's large properties. He notes that Devon leads in deepwater production in the Gulf of Mexico "where Exxon has little foothold." With oil at \$62 to \$65 a barrel, Gheit estimates Exxon's cash flow at \$52 billion and says its free cash flow could be \$22 billion. Even without a takeover, Devon shares, now at 71.45, will hit 90 to 100 by yearend 2008, he figures. When last featured in this column, on July 10, 2006, the stock was at 56. Tina Vital of Standard & Poor's says Devon has turned itself, through discoveries and acquisitions, "into a production-growth stock from a value-enhancing restructuring story." She rates it a buy. Both ExxonMobil and Devon said they don't comment on rumors.



Why Napco's Swoon May Be Brief

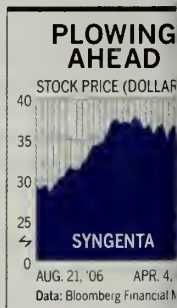
HAVING TUMBLING from 11 a share a year ago to 5.46 on Apr. 4, Napco Security Systems (NSSC) is hoping a new product introduced in January will pull it up. Napco's Web-based surveillance set-up, VIP-GatewayX, lets people monitor activities in their homes or offices through live video on computers or cell phones. Another Napco product, Freedom 64, is an alarm that uses no code. A special key simply locks or unlocks a homeowner's door. Easy to use, the system, introduced in December, automatically turns the alarm on or off through existing dead-bolt locks. Napco missed its earnings estimates for the second quarter ended

Dec. 31, 2006, prompting analysts to cut their forecasts. But James Clement of investment firm Sidoti retained his buy rating, with a 12-month target of 10, down from an earlier 14. A drop in European sales is behind the damage. CEO Richard Solloway says he expects VIP-GatewayX to be a "tremendous success" as major alarm companies placed orders and will advertise the product nationally. Joshua Jabs of Roth Capital Partners, also with a buy, sees Napco earning 31¢ a share in fiscal 2007 ending June and 36¢ in 2009, compared with 32¢ in 2006.



Farmers Rely on Syngenta In Their Fields

THE BOOM IN CORN PLANTING has been a boon to Syngenta (SYT), a Swiss seed and crop-protection company based in Basel. Its stock has jumped 34%, to 39.17 in the 13 months since the company was featured in this column on Mar. 13, 2006. Some analysts see more upside ahead. The brisk demand for corn to make ethanol, boosting farmers' need for Syngenta products to thwart field pests such as corn rootworm. Syngenta Chief Financial Officer Domenico Scala says 2007 will be a "volume growth story" driven by an improved farm market. He says Syngenta, which posted sales of \$8 billion in 2006, expects to return to shareholders \$800 million in 2007 through increases in dividends and share buybacks. Patrick Lambert of Swiss broker Cheuvreux sees earnings of \$12.35 a share in 2007 (before special charges), up from \$10.96 in 2006. His 12-month price target is 54. Alexandre Pasini of Bank Vontobel says 2007 will be a strong year as U.S. corn acreage is forecast rise 8%. This will lift commodity prices and lead to favorable planting conditions. He rates the stock "outperform." ■



BusinessWeek.com

ONLINE: Gene Marcial's Inside Wall Street is posted at businessweek.com/investor at 5 p.m. EST on the magazine's publication day, usually Thursday.
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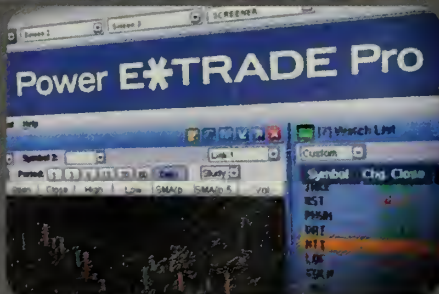
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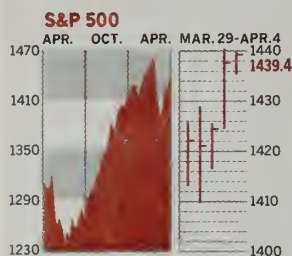
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STOCKS



COMMENTARY

The major indexes reclaimed some lost ground, a move fueled in part by the drop in oil prices. Shares of First Data soared 20.3% on news of a buyout, and shareholders at Starwood Hotels applauded the resignation of its CEO. Altria Group, which completed its spin-off of Kraft Foods, climbed 8.9%. GE got the jitters over new U.S. tariffs on goods from China.

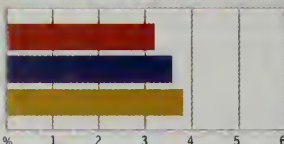
Data: Bloomberg Financial Markets, Reuters

MUTUAL FUNDS

4-WEEK TOTAL RETURN

WEEK ENDED APR. 4

■ S&P 500 ■ U.S. DIVERSIFIED ■ ALL EQUITY



52-WEEK TOTAL RETURN

WEEK ENDED APR. 4

■ S&P 500 ■ U.S. DIVERSIFIED ■ ALL EQUITY



Data: Standard & Poor's

U.S. MARKETS

	APR. 4	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
S&P 500	1439.4	1.6	1.5	10.2
Dow Jones Industrials	12,530.1	1.9	0.5	11.8
NASDAQ Composite	2458.7	1.7	1.8	4.8
S&P MidCap 400	859.4	1.4	6.8	8.3
S&P SmallCap 600	417.2	1.6	4.3	5.7
DJ Wilshire 5000	14,539.5	1.6	2.3	10.1

SECTORS

	APR. 4	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
BusinessWeek 50*	814.2	1.4	2.0	3.7
BW Info Tech 100**	452.0	2.4	1.0	12.5
S&P/Citigroup Growth	660.3	1.7	1.2	7.6
S&P/Citigroup Value	777.7	1.4	1.8	12.8
S&P Energy	472.6	1.6	3.7	14.6
S&P Financials	480.3	0.9	-3.0	8.5
S&P REIT	207.1	2.6	4.1	21.9
S&P Transportation	266.8	1.3	1.2	-6.2
S&P Utilities	205.8	1.4	10.3	29.9
GSTI Internet	210.1	2.2	5.2	6.1
PSE Technology	897.0	1.5	2.5	2.4

*March 19, 1999=1000 **February 7, 2000=1000

GLOBAL MARKETS

	APR. 4	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
S&P Euro Plus (U.S. Dollar)	2107.1	3.1	5.9	2.1
London (FT-SE 100)	6364.7	1.6	2.3	
Paris (CAC 40)	5739.0	3.4	3.6	1.1
Frankfurt (DAX)	7073.9	3.8	7.2	
Tokyo (NIKKEI 225)	17,544.1	1.7	1.8	
Hong Kong (Hang Seng)	20,209.7	3.4	1.2	2.1
Toronto (S&P/TSX Composite)	13,448.3	1.9	4.2	1.1
Mexico City (IPC)	29,370.9	4.5	11.1	4.1

FUNDAMENTALS

	APR. 3	WEEK AGO	YEA
S&P 500 Dividend Yield	1.81%	1.81%	1.7%
S&P 500 P/E Ratio (Trailing 12 mos.)	17.2	17.2	1.1
S&P 500 P/E Ratio (Next 12 mos.)*	14.8	15.3	1.4
First Call Earnings Surprise*	15.07%	3.91%	16.7%

*First C

TECHNICAL INDICATORS

	APR. 3	WEEK AGO	YEA
S&P 500 200-day average	1360.8	1356.1	Posit
Stocks above 200-day average	74.0%	73.0%	Negat
Options: Put/call ratio	1.08	0.98	Posit
Insiders: Vickers NYSE Sell/buy ratio	6.47	6.63	Negat

BEST-PERFORMING GROUPS

	LAST MONTH %		LAST 12 MONTHS %
Tires & Rubber	20.1	Tires & Rubber	129.4
Divsfd. Metals & Mining	16.9	Divsfd. Metals & Mining	44.3
Oil & Gas Refining	15.5	Power & Energy Traders	42.7
Steel	14.2	Steel	42.5
Coal	14.1	Leisure Products	38.3

WORST-PERFORMING GROUPS

	LAST MONTH %		LAST 12 MONTHS %
Homebuilding	-12.7	Homebuilding	
Forest Products	-11.0	Electric Mfg. Svcs.	
Employment Services	-8.8	Photographic Products	
Electric Mfg. Svcs.	-5.6	Distillers & Vintners	
Dvsfd. Commercial Svcs.	-5.4	Gold Mining	

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Latin America	11.9	Utilities	31.6
Pacific/Asia ex-Japan	8.5	Latin America	30.1
Natural Resources	8.0	Pacific/Asia ex-Japan	27.8
Diversified Emerging Mkts.	7.9	Real Estate	25.2
LAGGARDS		LAGGARDS	
Japan	-0.5	Japan	-6.7
Financial	1.0	Technology	1.7
Domestic Hybrid	2.2	Small-cap Growth	2.8
International Hybrid	2.7	Health	3.7

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
DireXn. Lat. Am. Bull 2X Inv.	22.7	Dreyfus Prem. Grtr. China A	51.3
ProShares Ultra Oil & Gas	17.7	iShares MSCI Malaysia Idx.	48.5
DireXn. Emrg. Mkts. Bull 2X	16.6	Old Mut. Clay Finlay Ch. A	47.5
ProFunds UltraEmrg. Mkts.	15.4	iShares MSCI Singapore Idx.	46.5
LAGGARDS		LAGGARDS	
DireXn. Emrg. Mkts. Short	-15.8	American Heritage Grth.	-40.0
ProShares UltSh. Oil & Gas	-15.3	DireXn. Emrg. Mkts. Short	-37.2
ProFunds UltSh. Emrg. Mkts.	-14.7	SPDR S&P Homebuilders ETF	-26.4
ProShares UltSh. Utilities	-12.8	DireXn. Dev. Mkts. Bear 2X	-26.0

INTEREST RATES

KEY RATES

	APR. 4	WEEK AGO	YEA
Money Market Funds	4.87%	4.87%	4.1
90-Day Treasury Bills	5.04	5.04	2.1
2-Year Treasury Notes	4.59	4.56	2.1
10-Year Treasury Notes	4.65	4.62	2.1
30-Year Treasury Bonds	4.84	4.83	2.1
30-Year Fixed Mortgage †	6.08	6.09	6.1

† BancQu

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND	30-YR. BOND
General Obligations	3.83%	4.2%
Taxable Equivalent	5.47	6.0
Insured Revenue Bonds	4.00	4.5
Taxable Equivalent	5.71	6.4

THE WEEK AHEAD

FEDERAL BUDGET Wednesday, Apr. 11, 2 p.m. EDT » The federal government probably ran a \$95 billion deficit in March, after a \$120 billion shortfall in February. That's the median forecast of economists surveyed by Action Economics.

FOMC MINUTES Wednesday, Apr. 11, 2 p.m. EDT » The Federal Reserve's Open Market Committee issues the minutes of the Mar. 20-21 monetary policy

meeting. Economists will try to get a feel for the central bank's views on housing, the subprime mortgage market, and stubborn inflation pressures.

EXPORT-IMPORT PRICES

Thursday, Apr. 12, 8:30 a.m. EDT » March import prices probably climbed 0.5% on higher energy prices, after a February gain of 0.2%. Export prices likely grew 0.3% in March, on top of a 0.7% increase in the prior month.

PRODUCER PRICE INDEX Friday, Apr. 13, 8:30 a.m. EDT » Producer prices are expected to have risen 0.6% in March, following a 1.3% surge in February. Minus food and energy, wholesale prices probably rose 0.2%, after a 0.4% gain.

INTERNATIONAL TRADE Friday, Apr. 13, 8:30 a.m. EDT » The February trade deficit probably widened to \$60 billion, after narrowing to \$59.1 billion in January.

The *BusinessWeek* production is improved to 291.6 for the week ended Mar. 24, an 8.1% gain from year ago. Before calculation of the four-week moving average, the index jumped to 293.3.

BusinessWeek .com

For the BW50, more investment data, and the components of the production index visit www.businessweek.com/extras.

Company Index

This index gives the starting page for a story or feature with a significant reference to a company. Most subsidiaries are indexed under their own names. Companies listed only in tables are not included.

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Earning it.
Investing it.
Spending it.



Check out this weekend's
show April 7 and 8:

New York Auto Show: Check
out the coupes, crossovers, and
concepts debuting this year,
plus the latest eco-friendly cars.

Driving Innovations: See how
new features and gadgets could
transform your experience as a
passenger or driver.

Credit Unions 101: Learn about
member benefits, how to join,
and why some customers are
better off at a standard bank.

Destination CEO: Anne Mulcahy
saved Xerox from near financial
disaster. Hear her plans to keep
the company moving forward.

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Wizards in the Valley

BILL & DAVE How Hewlett and Packard Built the World's Greatest Company

By Michael S. Malone; Portfolio; 438pp; \$26.95

At a Hewlett-Packard company event in the late 1960s, a brash young Japanese manager cornered the company's two founders and asked them to appoint him head of HP's underperforming Japanese business. Right then and there, William Hewlett and David Packard agreed. And within a year, the unit's performance had

improved dramatically, particularly with regard to product quality. A lucky hunch? No, says Michael S. Malone: Despite the company's 10,000-strong workforce, the founders kept "close track of the most promising employees well down the organizational chart." They just knew the cocky fellow was the man for the job.

Whether or not you completely buy this story may indicate how much you'll like Malone's *Bill & Dave: How Hewlett and Packard Built the World's Greatest Company*. There's little question that the author believes HP is worthy of the less-than-subtle superlative of his book's subtitle. With the cooperation of the founders' descendants, who provided access to family archives, Malone has produced a biography, management guidebook, and business history, all in one. A veteran journalist and former staffer in HP's public-relations department, Malone has also drawn from interviews with former employees and family members, news reports, and HP files. Despite its enthusiastic tone, though, even jaded business book readers will find much of interest here.

Anecdotes from the founders' childhoods highlight the book's opening pages. We learn that Packard was a top student in high school and lettered in three varsity sports, while Hewlett was an "indifferent" student who once detonated a homemade grenade fashioned from a doorknob. There's also a plethora of endearing trivia about the company's early days, including the tale of how the duo decided whose surname would come first in the company name. (They flipped a coin.) The author rehashes a bit of HP lore, telling how, for instance, during a visit to a machine shop, Packard absentmindedly fondled a plastic mold die. Not recognizing him, a technician snapped: "Get your finger off my die!" Packard quickly apologized. Malone acknowledges that the story is "so perfect that it seems to be fake."

The author does not neglect the founders' strategic and technical mistakes. In the mid-1950s the company desperately wanted to enter the business of oscilloscopes, which are used to measure and analyze voltage. In 1956, HP

unveiled the model 150A, which Malone says "suffered from terrible reliability problems." But no matter how HP battle rival Tektronix, it could never take more than 15% of the market. Consequently, "never again, they concluded, would the company attack an established market or competitor unless HP could offer a decisive contribution... no matter how lucrative the potential payoff," Malone writes.

Most thought-provoking are the sections on what's still known as "the HP Way"—the company culture noted for its emphasis on trust, empowerment, and employee appreciation. As you'd expect, there are stories of company picnics and gifts to employees who married or had babies. More intriguing

are passages on the culture's limitations. For example, soon after HP's initial public offering in 1957, Hewlett and Packard were chagrined to discover that some senior executives were flipping their HP shares. Thereupon the founders "decided to violate the HP tradition of trust" and impose a vesting period.

Later, as they opened offices in other communities, Hewlett and Packard faced the harsh reality that HP wasn't always loved outside of Silicon Valley. In the ranching town of Loveland, Colo., the freethinking HP workers began "stealing girlfriends and wives, driving up real estate prices, and increasingly dominating local politics," alienating longtime residents. In response, Hewlett and Packard decided that putting future offices in areas populated by affluent

educated folks would sidestep those kinds of culture clash. Malone, however, doesn't make it clear whether the strategy worked.

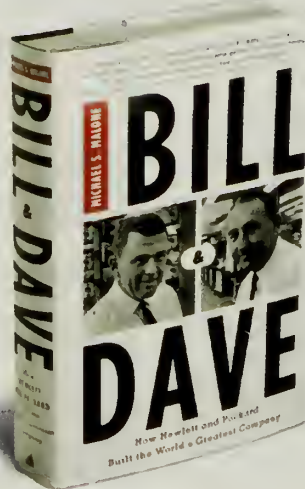
An appendix offers a list of "leadership lessons from Bill and Dave." These are generic and at times painfully obvious. Cases in point:

• "Take care of your smallest clients—they may one day

your biggest." And: "The biggest competitive advantage to do the right thing at the worst times."

A final chapter tackles recent history through 2006. While Malone is clearly unsympathetic to Carly Fiorina, the controversial CEO from 1999 to early 2005, he believes HP employees "heard Dave Packard's voice" in some of current CEO Mark Hurd's recent remarks. Maybe. But even if they didn't have that flashback, Malone probably did, hoping Hewlett can duplicate the passion Bill and Dave brought to the company that today has more sales than any other in techdom. ■

—By Louise



The absorbing, if gushy, story of Hewlett, Packard, and "the HP Way"

Because I can read,
I can understand. I can write a letter.
I can fill out a job application.
I can finally get off welfare.

Because I can read,
I can learn. I can help my daughter
with her homework.
I can inspire her to be better.
I can be a role model.

Because I can read,
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contribute. I can live
my life without fear,
without shame.
I can be whatever
I want to be.

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IdeasOutsideShot

BY SIR NICHOLAS STERN

The Global Climate Imperative

In January, scientists issued a stark warning that the Earth's average temperature could increase by as much as 6.4C (11.5F) by the end of this century. If greenhouse gas emissions continue to rise sharply, a jump of 4C (7.2F) would be most likely. It now is clear that the effects of climate change are potentially huge and irreversible. These scientific findings underscore

the urgency of coming to grips with the economics of climate change. Last year, I was asked to review the evidence and advise the British government on this issue. I came to a clear conclusion: that the costs of action to reduce the risks of climate change, while significant, are expected to be much smaller than the economic and human costs of the damage we face if we do nothing.

My analysis shows that global average temperature increases of 4C and above will bring substantial risks to every nation. Indeed, warming on this scale is associated with extreme weather events and serious impacts on food production and water availability in many areas. It also carries the risk of broader shocks such as sudden monsoon rains, significant reductions in water flow in the Nile River valley, and faster rates of sea-level rise—events that could trigger social instability, migration, and even conflict. My review (www.sternreview.org.uk) estimated the long-term damages, averaged over time and across a swath of possible outcomes, to be in the range of 5% to 20% of global consumption.

THE REVIEW HAS STIMULATED intense debate, with most of the response overwhelmingly positive. Yet some critics have focused on three areas. There are still commentators who prefer not to accept the science, despite the mounting evidence. Then there are those who are prepared to disregard future consequences simply because there is a time delay. (My analysis places much lower weight on a future dollar than a dollar spent now, since future generations may have higher consumption.) Still others assume future generations will be able to adapt to the changes. Adaptation is an important response, but there are real limits to what is possible. I believe all these criticisms are profoundly mistaken.

Reducing our dependence on fossil fuels, using cleaner technologies, increasing efficiency, and protecting forests together add up to an effective response that will reduce the risks of climate change and bring a host of other benefits

Reducing carbon emissions is a pro-growth strategy, not an economic burden

including energy security and improved health. The costs are likely to be in the neighborhood of 1% of global gross domestic product. Yet new lower-emission technologies also will provide economic opportunities for many businesses.

This presents a clear case for action. Reducing greenhouse gas emissions will not damage economic growth, but in the long run climate change itself could undermine growth. So action to reduce emissions is a pro-growth strategy.

Thankfully, this realization is spreading rapidly. Reducing the risks of climate change is a global challenge, and countries around the world have begun to step up to the plate. The European Union has strengthened its trading scheme for

emissions and is looking for carbon cuts of up to 30% by 2020. China has set a domestic goal of cutting energy intensity 20% by 2010. India has become one of the fastest-growing markets for renewable energy. And the U.S. is tackling the challenges of energy security and climate change at the federal, state, and local levels.

The next steps should include greater carbon trading to spur reductions wherever they're cheapest. But emerging carbon cap and trade arrangements in the EU, the U.S., and elsewhere must not develop in isolation, since there are big gains to be had from the creation of deep, liquid global markets. Faster development of new technologies is important, and here, too, cooperation yields larger markets for cleaner,

more efficient products and a pooling of risks.

If the U.S. can marshal its partners around the world to craft an effective global response to this challenge, I believe there is still time to avoid the worst risks of climate change. But time is running short. If we do not act now, the opportunity may not return. ■

Sir Nicholas Stern, former chief economist at the World Bank, is head of Britain's Government Economic Service.

BusinessWeek.com ONLINE: To join a debate about global warming between Stern and U.S. Chamber of Commerce President Thomas J. Donohue, please go to www.businessweek.com/extras.

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Ideas **The Welch Way**

BY JACK AND SUZY WELCH

The Importance of Being There

What do you think of telecommuting?

—Jennifer Heizer, Waltham, Mass.

We love it. Telecommuting allows us to write this column from Boston, Buenos Aires, or wherever our life happens to land us in any given week. Our editors are a phone call or e-mail away, and we communicate with them as easily as if we were in a cubicle down the hall in New York. So all in all, telecommuting is a perfect deal—for us.

For you, telecommuting may also be ideal, or it could be a total disaster, especially if you want to climb the corporate ladder. Because the facts are, even in this day of ubiquitous technology and open-mindedness toward flexible work arrangements, telecommuting still comes with a cost: diminished face time. Sure, that won't kill you in your early career. As long as you're an individual contributor with enough talent, you can do almost any job from home—write code, analyze legal documents, design marketing materials, or sell financial services. The list goes on and on and gets longer every day with the expansion of the intellectual economy and e-commerce.

But what you can't do very well from home is lead. To lead, it's no good blowing into town for important meetings and showing up at retreats. You have to muddle in the muck in between. People have to see how calm you stay in a PR crisis, how decent you are to new employees who don't have the hang of things, how much you sweat during a tough deal, and how hard you work on a deadline without bitching and moaning. Or how you don't do any or all of the above.

Which brings us back to face time. Companies rarely promote people into leadership roles who haven't been consistently seen and measured. It's a familiarity thing, and it's a trust thing. We're not saying that the people who get promoted are stars during every "crucible" moment at the office, but at least they're present and accounted for. And their presence says: Work is my top priority. I'm committed to this company. I want to lead. And I can.

Telecommuting sends another message, one that says you value lifestyle flexibility over career growth. Again, that can be just fine. We recently met a lawyer who has worked for her corporate headquarters in Illinois for 12 years from

her home in New Jersey. "My husband has a great job in Manhattan, and my kids love their school. I enjoy working with my colleagues, even if it is on the phone," she said. "Who needs to be CEO?"

Well, obviously she doesn't, and maybe you don't either. But for anyone who has dreams of leadership in any meaningful way, telecommuting can get you only so far. The road to the top is paved with being there.

My company places a great emphasis on colleague feedback in conjunction with the annual performance review, sometimes eliciting anonymous comments from as many as 30 people for an assessment. The whole process is so time-consuming. Is it worth it?

—Anonymous, St. Louis

You're referring, we assume, to the cottage industry known as 360 feedback, which first popped up about 20 years ago and has since spread across the business terrain. And for good reason: 360 feedback is an unvarnished way for people to receive a wake-up call about behaviors that distress their peers and subordinates. One of us (Suzy) once attended a leadership-training program where she saw another participant, a middle manager from a technology company, practically go into shock over his 360 results, which were a veritable Greek chorus of negativity. "Impossible—my people love me!" was the manager's reaction. "They must have mixed up the paperwork!" They hadn't.

But the problem with 360 feedback, and it's a big one, is that after about the second time around, it gets gamed. The system devolves into a highly negotiated affair in which colleagues work out nuclear deterrence treaties with each other, and all the "feedback" shooting back and forth starts sounding the same—i.e., positive. Perhaps such behavior is all too human, but it renders the process useless.

Now, we know that 360's proponents, and they are legion, claim the system has safeguards, and surely it has some. But you ask whether the whole long process is worth it. And to that, we'd have to say traditional appraisals, boss to subordinate, still win hands-down. They generally work, save everyone time, and are very hard to rig. We'd suggest your company, then, not eliminate 360 feedback but use it only every few years. Its main value is to "out" the unspoken. And that, almost everyone's in on the game. ■

Jack and Suzy Welch look forward to answering your questions about business, company, or career challenges. Please e-mail them at thewelchway@businessweek.com. For their weekly podcast go to www.businessweek.com/search/podcasting.htm.

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**The Truth About
Capital Spending**
(PAGE 30)

'YOU'RE FIRED!'

**NOT
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**Why axing
problem workers
is tougher
than it looks**

by MICHAEL OREY
(PAGE 52)

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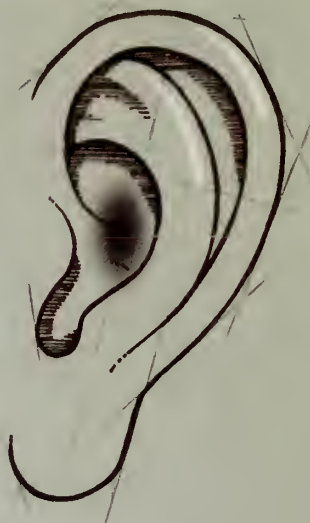


There is nothing wrong with their voices. Some are booming. Some are animated. Some are downright mellifluous. But all the same, professors at the University of Virginia's Darden School of Business would rather hear students speak.

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News & Insights

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Businesses that had given most of their funds to the GOP are betting on Democrats this election cycle

Buyer Beware at Chrysler

New owner will have to outsource engineering, R&D—even car loans

Free Information, Please

Google is the latest tech player to join lucrative directory assistance market

Revolt Against the SEC

Coalition of business groups argues that financial regulators have gone too far

The Battle of Britain

Bert Murdoch and Richard Branson throw the gloves off over satellite TV

Risky Business in Moscow

PricewaterhouseCoopers, former auditor of Enron, is in a precarious place

Global Business

How Cheap Can a Car Get?

At \$3,000, as Tata and Renault lead global derby downmarket

The Great Indian Beer Rush

Locals have little taste for the suds, but foreign brewers are racing in

FOR GLOBAL COVERAGE:

For additional insights into European and Asian business, please go to www.businessweek.com/globalbiz

Economics

Business Outlook

Cooper says labor markets will be increasingly vulnerable over the next months

BusinessWeek (ISSN 0007-7135) Issue number 4031, published except for one week in January, July and August, by The McGraw-Hill Companies, Inc. Executive, Editorial, Circulation, and Advertising Offices: 1221 Avenue of the Americas, New York, N.Y. Periodicals postage paid at New York, N.Y. and at additional offices. Canada Post Publication Mail Agreement Number 01. Return undeliverable Canadian addresses to: DPGM Ltd., Bath Road, Mississauga, ON L4T 1L2. Email: bwkcustserv@mcgraw-hill.com **Subscriber:** Send address changes to BusinessWeek, P.O. Box 8418, Des Moines, IA 50319-1418



Cover Story

52 Fear of Firing Never mind *The Apprentice*. The days when a boss could get rid of an underperformer or problem employee on the spot are long gone. Now workers in an expanding list of categories—women, gays, white men alleging bias—have companies scared to lower the ax, even if workers' job performances fall seriously short



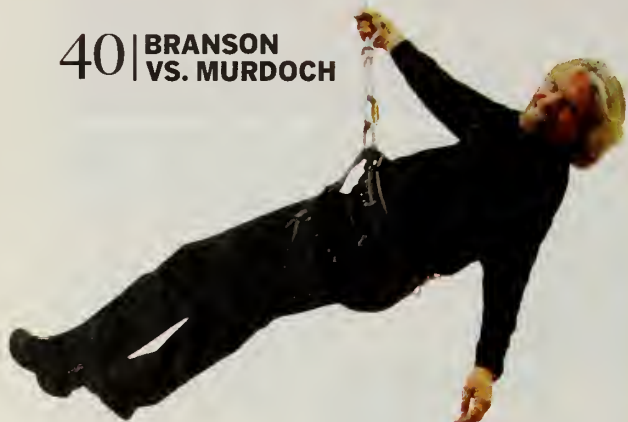
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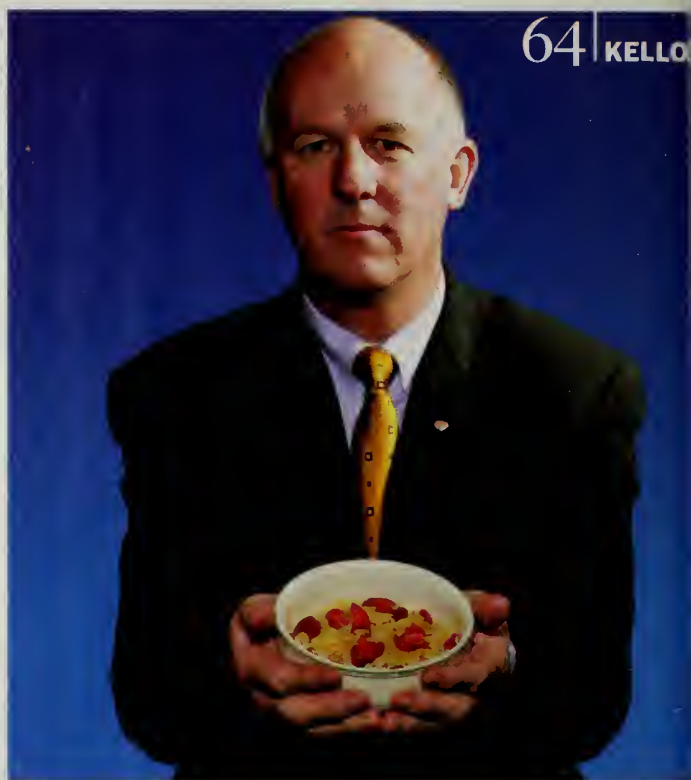
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Lifestyles of the rich and savvy: It's still a seller's market for those with luxe homes

If You Have to Ask...

At a time when the U.S. property market is softening, there's one category that is still going strong: the priciest properties. Our **BusinessWeek.com special report on Luxury Real Estate** takes a look at homes at the top of the market and why they make the best investment. It's good news for buyers who were willing to spend a little more for houses in established luxury markets. Case in point: Already affluent Greenwich, Conn., which has **the Zip Code with the highest median home prices** in the U.S. Thanks to the recent influx of megarich hedge fund managers, who have bid up prices in the tony suburb of New York, homes with an 06831 Zip Code have a median price of nearly \$3 million, a 49% increase since 2001. Other well-heeled burgs that saw values soar are Newport Beach, Calif.; Glen Head, N.Y.; and Bellevue, Wash. We also look at which states have **the most \$1 million-plus homes**, check out the states that are likely to see the next real estate boom, tour a \$35 million Sonoma Valley mansion, and look back at some no-longer-luxury neighborhoods that have seen better days. Go to www.businessweek.com/go/07/realestate for all this and more.

BusinessWeek weekend

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A photograph of a living room at night. In the foreground, the backs of a man and a woman are visible as they sit on a couch, watching a television. The TV screen displays a painting of a man in a red coat and hat, possibly a historical figure, standing in a landscape. To the right of the TV, a lamp with a warm, yellow glow sits on a side table. The room is dimly lit, with the primary light source being the lamp and the TV screen. A small, white rectangular box with black text is positioned in the upper right corner of the image.

"Programming Chief" Seattle, WA.
Image courtesy of the human network.

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FUNDAMENTAL STRENGTH - CAPITAL AND PE

JP Front

"He's made billions by coming in, buying low, cutting jobs, and throwing people out of work, then selling."

—Canadian Auto Workers President Buzz Hargrove on his plan to fight billionaire investor Kirk Kerkorian's \$4.5 billion bid for Chrysler, as reported by The Associated Press

BY DEBORAH STEAD



HA Gas
porters'
ers may be
rblown

ENERGY JITTERS

A Natural Gas OPEC? Not Likely

TO THOSE WHO recall the rise of the Organization of Petroleum Exporting Countries in the 1970s, the prospect of a cartel among natural gas exporters is worrisome. The first two-day meeting in Doha, Qatar, of the world's biggest exporters raised the alarm among gas-importing nations. The concern is that these countries, which collectively control about 40% of the export market and 73% of the world's natural gas reserves, could have Western nations under their thumb with an OPEC-style group. But while the Apr. 9-10 meeting of the Gas Exporting Countries Forum—which includes Iran, Algeria, Russia, and Venezuela—produced jitters, the prospect of its leading to a powerful organization is unlikely, analysts say. One reason: Because the world has vast untapped natural gas reserves, the rise

of such a cartel would sow the seeds of its own destruction, spurring innovation in extracting hard-to-reach reserves. Already, analysts point to "huge" finds in countries like Brunei and India. "An OPEC in natural gas could succeed brilliantly for a year or two, until high prices lead to efficiency gains and more discoveries," says Bernard Picchi, an analyst for **Wall Street Access**, which follows the industry.

The threat of higher gas prices could also push importers to develop other power sources, experts say. "There are alternatives," says Peter Beutel, president of **Cameron Hanover**, a New Canaan (Conn.) energy consulting firm. "Utilities can use coal or nuclear."

The idea of a natural gas cartel "scares the bejesus out of people," Picchi says. "But it's not realistic."

—Maira Herbst

EXEC COMP

DOLLAR-A-YEAR (OR LESS) MEN

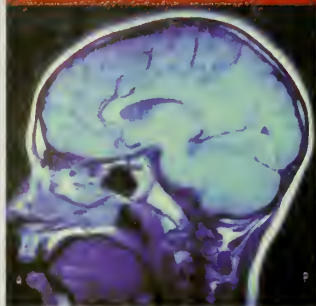
AS GOOGLE'S 2007 proxy filing on Apr. 6 revealed, Chairman and CEO Eric Schmidt and founders Larry Page and Sergey Brin get salaries of just \$1 a year. The three are part of an exclusive fraternity of founders, scions of corporate dynasties, and holders of company shares whose stock ownership makes them millionaires so many times over they can live without a paycheck. (Some still get a hefty annual comp, mostly from stock or option gains.) Below, a list from executive compensation research firm **Equilar** of CEOs in the Standard & Poor's 500-stock index in 2006 who were paid \$1 or less, according to the most recent proxy. The list doesn't include John Mackey of **Whole Foods Market**, who voluntarily lowered his salary to \$1 starting Jan. 1, 2007. —Jena McGregor



CEO	Salary	Total Compensation*
Steven Jobs Apple	\$1	\$1
Richard Fairbank Capital One Financial	0	151,484
James Rogers Duke Energy	0	10,203,486
William Ford Jr.** Ford Motor	0	7,248,733
Eric Schmidt Google	1	557,466
Richard Kinder Kinder Morgan	1	1
Jerrold Perenchio Univision Communications	0	0

*Total compensation, calculated by Equilar, reflects amount CEO made in salary, bonus, cash-incentive-plan comp, vested stock awards, option gains, and "all other" compensation such as perquisites. **CEO until Sept. 1, 2006 (now chairman); replaced by Alan Mulally, who earned salary of \$666,667 in remainder of year, plus \$19.5 million in bonus and other comp. Data: Equilar Inc

HEAD GAMES



NOW, THE WARM AND FUZZY MRI

Hospitals lose money when frightened patients require extra time for CT scans or MRI procedures. So electronics giant Philips is offering an "ambient experience" to calm children and nervous adults. At Advocate Lutheran General Hospital near Chicago, where the system was launched, kids pick from fantasy settings that include images of friendly space aliens projected around the scanning suite. Adults can opt for nature scenes.

The system has decreased by 28% the number of children age 4 and under who need sedation, says Dr. John Anastos, Advocate's radiology chairman. Sedation can stretch a 30-minute session to four hours, he says, and reduce daily per-machine use from four scans to one.

Five other U.S. hospitals now use Philips' product, which costs about \$125,000. With it, patients "balk less, and the hospital gets better bang for its buck," Anastos says. —Aili McConnon

PRINT IT

INKJETS THAT GO LICKETY-SPLIT

IN FEBRUARY, Antonio Perez, a Hewlett-Packard alum and now chairman and CEO of Eastman Kodak, challenged his old employer, announcing a printing system designed to underprice HP's printers. Now, other former HP employees want to take on the printer king. This time the selling point is speed.

Led by former HP printer executive Bill McGlynn and other ex-HPers, Memjet Home & Office is selling technology that lets inkjet printers produce 60 pages a minute, many times faster than current rates. McGlynn says three companies have ordered the technology from his Eagle (Idaho) startup to use in home printers expected to retail under their



brand names for about \$300 in early 2008. Glynn won't identify his customers but insists their brands are well-known. Ink for the printers is expected to sell at a fifth of the price of most cartridges.

Memjet's technology creates speed partly by using a print head the same width as the paper—so an entire line is printed at once.

HP is unimpressed. Glen Hopkins, the company's vice-president for R&D in inkjet printers, says Memjet

may be achieving speed at the expense of quality and reliability. "There's nothin breakthrough here," he says. (On Apr. 11, HP unveiled a inkjet printer for business built on its Edgeline technology, which produces printing at speeds as fast as Memjet's.) But industry watchers are taking notice. Memjet. Printer makers want to ignore this dynamic upset at their own peril," says Steve Hoffenberg of Lyra Research. —Louise L



PLAYING VEGAS

ONCE AND FUTURE SPAMALOT

A MEDLEY of musicals have lost their shirts in Las Vegas, including *Hairspray* and *We Will Rock You*, which closed after short run in 2005. The latest to press its luck: Monty Python's *Spamalot*, which opened on Apr. 1 in the same theater at the Wynn Las Vegas casino that briefly housed *Avenue Q*.

But Steve Wynn is placing his bet carefully. He expanded his theater's balcony so he can sell 1,500 tickets to each show instead of 1,200. And he has kept prices low by Vegas standards: Seats start at \$49 and top out at \$99. What's more, Wynn's deal with *Spamalot* bars the show—now touring the U.S.—from playing in Southern California or Arizona. (The two states provide more than a third of Sin City's visitors.)

Britain's Eric Idle, who wrote the lyrics and co-wrote the music to *Spamalot*, trimmed the Vegas version by 20 minutes cutting the intermission. That lets Wynn run two shows some nights. It also gets guests out into the casino where they can shop, eat, or gamble. Idle says he has long had his eye on Vegas, despite *Spamalot*'s lack of resemblance to the Cirque du Soleil shows that draw crowds there. "It isn't in French, and it doesn't involve acrobats," he says. "We're not a circus—we're a flying circus." —Christopher Palmer

HOLY GRAIL?

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SOUTHERN COOKING

WHERE THE HAMBURGER JOINT IS A WAY OF LIFE

THEY SURE LIKE Mickey D's in Dixie. And Burger King and Wendy's. A just-released survey by restaurant consultant Sandelman & Associates shows that fast-food customers ate at a quick-serve place 25 times a month in McAllen, Tex., more than any of the other 60 markets polled, with burgers the popular

order. In Portland, Me., fast-food eaters stopped in just 11 times a month. The national average: 17. Why are the top markets Southern? Sandelman President Jeffrey Davis says the Sunbelt and fast food grew up at the same time, making outlets like McDonald's part of the cultural fabric. —Michael Aron

HIGHEST 10 CITIES LOWEST 10 CITIES

PER CAPITA NUMBER OF MONTHLY FAST-FOOD MEALS

SEATTLE, WASH. 13

PORTLAND, ORE. 13

BOISE, IDAHO 13

SAN FRANCISCO, CALIF. 14

ANCHORAGE, ALASKA 12

EL PASO, TEX. 21

OKLAHOMA CITY, OKLA. 21

SAN ANTONIO, TEX. 21

MINNEAPOLIS, MINN. 13

PORTLAND, ME. 11

BOSTON, MASS. 13

NEW YORK, N.Y. 13

PHILADELPHIA, PA. 13

CHARLESTON/HUNTINGTON, W.VA. 20

GREENVILLE, N.C. 24

RALEIGH/DURHAM, N.C. 20

COLUMBIA, S.C. 20

MEMPHIS, TENN. 22

DALLAS, TEX. 21

McALLEN, TEX. 25

Data: Sandelman & Associates poll of 70,000 people in 2006 about fast-food meals in previous month. 90% of Americans say they eat fast food.

LAWN ORDER

NOW, THAT'S REALLY A TURF WAR

IT'S A BATTLE over the nation's yards and gardens. Lawn-care giant **Scotts** **Miracle-Gro** is suing **TerraCycle**, an organic plant-food startup with a product line based on earthworms.

In TerraCycle's Trenton (N.J.) factory, night crawlers munch on organic waste, and their nutrient-rich droppings are blended into a solution sold in reused soda bottles. TerraCycle sales hit \$1.8 million last year, a 300% leap.

The green-and-yellow bottles, bedecked with

images of vegetables and flowers and designed to allow spraying, are a problem, says Scotts, whose sales are at \$2.7 billion (including its competing Organic Choice line, which grew by 200%).

In March, the Marysville (Ohio) company sued

TerraCycle in the U.S. District Court of New Jersey, claiming its packaging infringes on the "distinctive and famous trade dress" of Miracle-Gro. Scotts also characterizes as false TerraCycle's claim that its fertilizers are as good or better than "a leading synthetic plant food."

Scotts spokesperson Su Lock declined to comment on the case. TerraCycle denies the charges.

At suedbyscotts.com, TerraCycle presents scores of photos of plant products packaged in the same colors it uses. And so far, it has refused to share the Rutgers University studies it says prove its wormy elixir makes for perkier plants. —Adam Aston



TRENDSPOTTING SHARP EARS

» YUM! BRANDS' KFC

will use high-frequency sound—not to repel the much publicized rodents that recently plagued one of its New York outlets, but to appeal to young people. The company is deploying the Mosquito Ringtone popular with teen mobile users to sell its boneless chicken bucket. (The tone can't be heard by most over-30s.) The TV ads will emit the noise, with KFC giving free chicken bucket to the first 1,000 viewers who go online and say just when in the ad the tone played. —Aili McConnon

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ANALYZE THIS

BY KERRY SULKOWICZ, M.D.

Me, Me, Me, Me, Me

We have an employee who turns every interaction—work-related or not—into a conversation about her. She's otherwise good at her job, but folks are beginning to avoid meetings with her or task forces on which she serves. "She sucks the air out of the room," a co-worker complained. Is there a polite way to stifle this behavior?

—Anonymous, Seattle

THIS EMPLOYEE'S need for attention may arise from old experiences of emotional deprivation and neglect. She compensates by greedily forcing others to focus on her.

That's understandably annoying to colleagues, who are obviously losing patience. (The word "stifle" gave you away.)

Since the current strategy, avoidance, doesn't seem to be helping, you're going to have to confront her about this.

That doesn't mean merely hinting. Correcting this sort of person indirectly ("let's get back to what we were discussing") won't work. She's likely to experience such comments as interruptions of her monologue. Instead, someone—preferably her supervisor or a colleague who has enough of a relationship with her so that constructive observations aren't rejected out of hand—should talk to her privately.



Politely but firmly, tell her that her work is valued but that she may not realize how much she turns the subject to herself. Explain that "it derails conversations, and people have started avoiding you because they feel you don't listen." You'll need to keep your contempt in check. Otherwise, she may make that the subject of your talk, once again hijacking the discussion to meet her needs.

I just left a job where my boss constantly put me on the spot, frequently demanding, for instance, that I settle disagreements between him and someone who was also my superior. What should I have done?

—Anonymous, Los Angeles

YOU'VE ALREADY taken steps: You left. Others stuck in this dynamic might begin to address it by asking themselves if they are subtly offering themselves up as pawns—as a way of feeling at least a bit important. And a boss like this? Maybe he can't take responsibility for difficult or uncomfortable encounters. Maybe he takes sadistic pleasure in a making a subordinate squirm.

Whatever his problem, if you get into this situation again, try appealing to your superior's ego while enlisting his guilt: "I need your guidance. I'm in an awkward situation here, trying to mediate between the two of you. How would you advise me to handle it?" It's a long shot, but if your supervisor has enough empathy to see the problem he's created, it can make a difference. If not—well, sometimes we have to accept the unlikelihood of change in someone on whom we're dependent. And separate from them.

Kerry J. Sulkowicz, M.D., a psychoanalyst and founder of the Boswell Group, advises executive on psychological aspects of business. Send him questions at analyzethis@businessweek.com.

QUESTION OF THE WEEK

What's the strangest or most outrageous tax deduction you've encountered as a tax preparer?

Lots of clients with expensive pets or big veterinarian bills ask if they can list their pets as dependents. And only some of them are kidding.

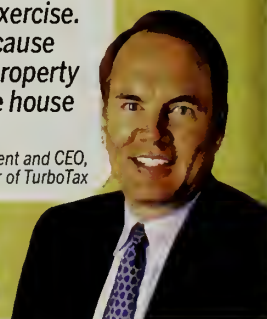
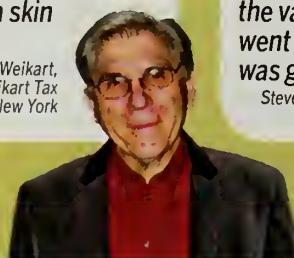
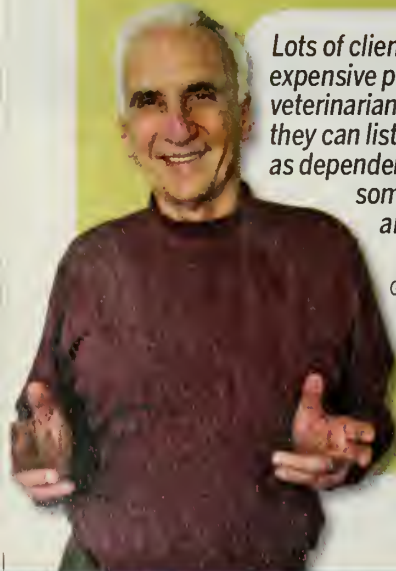
Mat Tecosky, Bush, Tecosky, Carroll, Goodman, Feldman, Huntingdon Valley, Pa.

A woman wanted to know if she could deduct the value of the excess skin she had removed after losing 200 pounds. She'd donated that excess to a skin bank.

James Weikart, Metis Weikart Tax Associates, New York

Someone tried to deduct his house, which he'd given away to his local fire department to burn up in a training exercise. He couldn't—because the value of his property went up once the house was gone.

Steve Bennett, President and CEO, Intuit, maker of TurboTax



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Todd Morici

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he finds so impressive, but the fact that it is so easy to use.

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turn on my lumbar massage, even dim the cabin lighting with a couple of clicks. Everything is completely intuitive." The car's COMAND technology allows him to navigate his way to everything from one location which is thoughtfully placed right at the center console.

In the cabin, fine leathers and polished woods spread across the vast and spacious interior while fiber-optic ambient lighting sources provide a warm and comforting glow. Outside noise is kept outside through specially insulated doors and dual-pane windows.

Morici concludes his review with a smile: "I'm a car guy. The more you know about cars, the more you want to drive this one."



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Imagine...a reverse avatar of Tiger Woods projected onto a student golfer... [who] strives to match his movements exactly..."

—Alan Dean Foster
Prescott, Ariz.



MORE MIRACLES OF MOTION CAPTURE

WHILE I ENJOYED "The mind-bending new world of work" (Cover Story, Apr. 2), it made no mention of reverse avatar (RA) technology.

With RA, instead of projecting an operator image onto a computer-generated figure or into a computer-generated setting, the RA technology projects a semi-transparent 3D image onto the operator.

Imagine, for example, having a reverse avatar of Tiger Woods projected onto a student golfer. As Woods swings or chips or putts, the wearer strives to match his movements exactly. A failed swing is indicated by an alarm and accompanied by instruction from the integrated programming on how to correct the motion. When the swing is executed correctly, the program lets you know it.

—Alan Dean Foster
Prescott, Ariz.

YOUR ARTICLE is right on the mark. It accurately describes the way gesture recognition, via video cameras and gyroscopes combined with cost-effective computing power, offers a natural computer

interface that empowers and engages whole bodies in the process.

Your story correctly points out that most of the companies that created the original virtual reality (VR) motion-tracking technologies "crashed and burned," disappearing without fulfilling the early hype. One clear exception, however, is GestureTek, which was founded 20 years ago. Our solution requires no special gloves, helmets, or other props.

We have thousands of customers, including several that were featured in your story (Ford, Intel, Microsoft, and Monster Media), and we continue to lead in state-of-the-art gesture-tracking technologies and patents.

—Bill Leckontz
Chief Executive Officer
GestureTek
Portola Valley, Cal.

RASPBERRIES FOR MICROSOFT SEARCH

ONE SYSTEMIC, COMICAL problem with Microsoft Corp. is how it understates its missteps and failures and talks up what it wants to do and where it wants to go.

In "Where is Microsoft search?" (New

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The McGraw-Hill Companies

BusinessWeek

APRIL 23, 2007 (ISSN 0007-7135) T 4031

Published weekly, except for one week in January, July and August by The McGraw-Hill Companies, Inc. **FOUNDER:** James H. McGraw (1860-1948).

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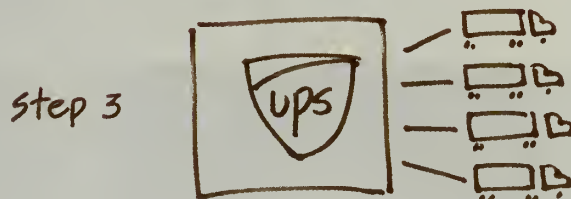
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WHAT CAN BROWN DO FOR YOU?™



ReadersReport

& Insights, Apr. 2), a spokesperson says: "We could have been a little crisper." Are you kidding me? Split pea soup is crisper than Microsoft's execution. The company needs to understand that vaporware and pulling the wool over people's eyes are relics of a distant Cold War era. These days, honesty and flawless execution are what matters.

—R. Krishnan
Toronto

THE STUMBLING GOLIATH continues to trip over its past successes, leaving agile companies such as Google Inc. and Yahoo! Inc. to run circles around it. The irony is that while Microsoft keeps swinging at the swarming armies, Google and other rivals are barely taking notice.

Microsoft's slow suffocation is less the work of its Spartan-like competitors than the inevitable result of the company's neglect of its customers. To borrow from Ralph Waldo Emerson's essay on compensation: Microsoft's punishment is a fruit that unsuspected ripens within the flower of the pleasure which concealed it.

—J. Allan Brown
Pleasanton, Calif.

UNION ORGANIZING VIA CARD CHECK IS NOTHING NEW

ALTHOUGH I WAS stunned at the biases and exaggerations rampant in "The unemployment act" (The Welch Way, Mar. 12), I finally recognized it as just another management-side diatribe. (Union leaders are often equally bombastic.)

BusinessWeek's follow-up, "Unions: The great divide" (Feedback, Apr. 2), says the Employee Free Choice Act "would change the rules of labor elections by replacing the secret ballot with 'card check.'" In fact, card-check certification has been legal for more than 70 years, along with elections, since the 1935 passage of the National Labor Relations Act. Increasingly, unions are using the card-check method of organizing for a variety of reasons.

Even if the Employee Free Choice Act does not become law, the use of card check will continue to rise. Employers have become so proficient at defeating organizing campaigns ending in elections that unions have moved increasingly to card check.

—Joseph C. Ullman
Emeritus Professor
University of South Carolina
Blythewood, S.C.

CORRECTIONS & CLARIFICATIONS

In "Hot properties, half a world away" (Personal Finance, Apr. 16), the footnote in the table showed an incorrect share price return for RMR Asia Pacific Real Estate Fund. The correct figure is 1.7%.

"Groundbreakers from two originals" (Executive Life, Apr. 16) listed the wrong label for Neil Young *Live at Massey Hall* 1971. It was released by Reprise Records.

UNDERGRAD B-SCHOOLS: WHAT THE RANKINGS MISS

BY FOCUSING ON characteristics such as school size and location in "The best undergrad B-schools" (Special Report, Mar. 19), *BusinessWeek's* rankings fail to measure the value added by schools that are smaller and off the beaten path.

Senior faculty here at the University of Tennessee, for example, spend most of their time teaching and mentoring undergraduate students. In academic circles, institutions such as ours are referred to as "teaching schools." Faculty at "research schools," in contrast, spend more of their time working with



essential₂unle

D students and keeping up their own publishing schedules. At many of your ranked schools, faculty-student ratios are supplemented by assigning doctoral candidates and junior lecturers to teach undergraduates.

Also, while your analysis makes some adjustments, the starting salaries reported in your table favor institutions whose graduates work in high-cost-of-living areas. With respect to recruiting, your readers should know that the market for qualified B-school graduates is as strong on Main Street as it is on Wall Street.

SAT and ACT scores measure students' proficiency upon admission, but they do not indicate the educational effectiveness of an institution. In fact, colleges with moderate acceptance scores bring more students further up the curve than schools with more restrictive admission policies. Next year you might ask the faculties of your top-ranked undergrad B-schools what factors are most important in their promotion, tenure, and merit processes. You may find their answers to be quite educational.

—Thomas H. Payne
University of Tennessee
Martin, Tenn.

PLENTY OF BUSINESSMEN, BUT ONLY ONE THOMAS EDISON

AFTER READING YOUR review of *The Wizard of Menlo Park* ("Invention deficit disorder," Books, Apr. 2), I was left feeling that the reviewer doesn't understand the appropriate (and limited) role of an inventor in the business world. As an inventor, I don't buy the attempt to belittle Thomas Edison's achievements.

To conclude that Edison was not all that successful because he died without being "fabulously wealthy" misses the point: Inventors are not due anywhere near all the credit for and profits from their creations. And are we to assume that all attempts in life are failures if the creative person doesn't die wealthy? Even if wealth is the key measure, Edison's estate valuation of "only" \$1.5 million was an enormous fortune in the early 1930s.

The reviewer also criticizes Edison for repeatedly refocusing from one invention to another. Would he have had him focus on only his first, trying to wring every dollar out of it and preventing other inventors from standing on his shoulders and improving on his work?

This inventor vs. businessman conflict is an apples-to-bananas comparison. It

isn't that they compete, as they both need each other. The inventor provides the idea, and the business enterprise marshals the many aspects needed to extend the idea's reach.

Edison was a genius and a visionary, if not a topflight businessman. So what if he sought and received a lot of publicity? He deserved it.

—G. Gregoire
San Diego

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Harnessing Social Networks

Just when you thought you and your business were getting the Web down cold, social networking has come along to confuse matters. After a decade of exposure to the Internet, mom-and-pop businesses and international giants alike have learned to make effective use of the Web. Now they need to figure out new strategies as the Web morphs from a mainly one-way

method of communicating with customers to a free-for-all of user-created content.

Many of the companies reaching out to the teens and twentysomethings who populate MySpace have built their pages on that service, owned by News Corp. The page for American Eagle Outfitters, for example, is mostly an ad for the youth-oriented clothing chain, but it also features discussion forums that cover topics from fashion to store employment. The company has 36,000 MySpace "friends." Some businesses also post videos on YouTube; Hewlett-Packard is sponsoring a contest for the best video featuring an HP calculator.

One of the odder places attracting business interest is Linden Labs' Second Life, a virtual world where avatars—3D cartoon representations of players—live, love, and try to get rich. IBM has built a replica of its Almaden Research Center in Second Life, and Coldwell Banker has opened a virtual office to sell virtual real estate. But for all the buzz, it's not clear to me that Second Life is much of a business investment. Linden Labs claims 5.2 million "residents," but only 1.6 million have logged on in the past two months, and there are generally fewer than 50,000 around at any one time.

A STARTUP CALLED NING, backed by former Netscape Communications honcho Marc Andreessen, may be a better bet for small-to-midsize businesses that want to get into the social-networking game without making a huge commitment of either time or money. Ning is a hosting service and a set of tools that let any individual or organization—a soccer team, a church choir, or a business—create its own social network.

Using Ning to set up your network requires a bit of skill: It's much like creating a Web page. But once you're up, adding videos or a photo gallery to the design is simple. And Ning offers all the standard tools of the social-networking trade: discussion forums, blogs, and lists of "popular members."

A basic Ning account is free, but "free" comes with some features you may not want and will have to pay to get rid



A new service lets companies get into the game quickly

of. The most significant is that Ning runs ads by Google down the right side of the page. You not only get no revenue from the ads being run on your site but also risk the chance that the text spots, linked thematically by Google magic to the content on the page, might contain something you'll consider offensive—or even promote a competitor's business.

For \$19.95 a month you can replace Ning's ads with your own ad service or lose the ads altogether. Another \$4.95 a month lets you change the address of the network from "mybusiness.ning.com" to "mybusiness.com." And \$7.95 a month more removes a link that lets members of your networks create networks of their own, which could include an "I hate your business" network.

Taking the plunge into social networking raises challenges for any business. When you let customers or prospective customers participate, you have to pay close attention to what they're saying. You are going to get negative and sometimes ugly comments (BW—Apr. 16), but you have to accept that as part of the culture of the Web.

The upside is that building a social network around your business can not only give you a richer way to communicate with customers but also a golden opportunity to learn what they're thinking. That can make it well worth the effort. ■

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These Are Troubled Times

A good newspaper provokes a terrible, swooning sentimentality among journalists: Those gorgeous expanses of words and pictures! That miracle realized on a daily basis! And none does so more than *The New York Times*. Despite massive, well-annotated recent failures (greetings, Jayson Blair and Judith Miller) it remains, deservedly, the planet's most significant

print property. But its parent's stock is a loser even by the sluggardly standards of its industry peers, and it's undergoing a sustained attack from Morgan Stanley portfolio manager Hassan Elmasry. He's taking aim at the two-tiered, family-controlled stock structure and the management of Chairman Arthur Ochs Sulzberger Jr. and Chief Executive Janet Robinson (not necessarily in that order). T. Rowe Price Group, which owns about 15% of the common stock, is expressing displeasure as well. Investors holding around 30% of the common stock withheld directors' votes at last year's annual meeting. Advisory groups Institutional Shareholder Services and Glass, Lewis recommend shareholders do the same at this year's meeting on Apr. 24.

But no Thrilla-in-Manila showdown looms. The company is controlled by a trust that was set up, the proxy states, "to maintain the editorial independence and integrity of *The New York Times*." The votes of six of its eight trustees, all of whom are family, are needed to change the trust. Former Times Co. executives find that prospect comical, and no dissidents within the tight-knit and -lipped family have surfaced.

TO PUT THIS IN PERSPECTIVE: In the '90s, a disgruntled faction did arise within the Bancroft family, whose shares control Dow Jones & Co. For those of you keeping score at home, Dow Jones was never sold. It was years before its top management changed. And no shareholder bought Times Co. stock without knowing exactly what kind of company it was.

The Times Co., which last year posted operating margins of about 15%, has not been a great business lately. But—hey! That's an improvement over the barely profitable stretches of its past. (You can easily interpret the company's history as a triumph of product quality—with all its costs—over management.) Unlike past agitators, Elmasry recognizes that merely screaming about stock structure won't change a family's mind. This is why, at a February board meeting to which he was invited to air his gripes, he artfully pitched family members on how breaking up the Times' dual-class



stock would better protect the crown jewel of the *Times* itself. (This logic is lost on me, but points to him for trying.) He's a impatient with the shrug-shoulders excuse that because newspapers are mature and challenged their stocks have tanked. His presentation cited at least one company in another stagnant, long-in-the-tooth business—retailing—that has prospered relative to its peers.

This is a smart point, but it may not be applicable. *The New York Times*—which last year generated 63% of company revenue—does not, like other newspapers, sell access to a defined geographic market. It sells access to a national elite. Its claim to that audience—how to say this without sounding like a sob sister for capital-J journalism?—is based on the distinctiveness of the *Times*, with all its premium-brand beliefs. Should a way to make money off top-shelf Web content arise, the *Times* is uniquely positioned to do so, assuming

But is the paper's stock structure in danger? In a word: No

the franchise stays strong.

As for whether market forces ever enhanced, or even recognized, the value of a premium print product—well, that's crazy talk. There was a hard-drinking Southerner last century who liked to write. For years market forces told him his work was unsalable. Had he listened to the market, he'd have quit. For whatever reason, he didn't. The sentimental response is to be glad William Faulkner kept at it. The cold calculated response is: If William Faulkner Inc. had sold shares in the lean years, today you'd be really, really happy you bought in. ■

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Flying or fishing, success is catching in Ohio.

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the tightly regulated demands
the aerospace industry.
from work, Mark
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MARK SEIDEL'S STORY

**"Ohio is fantastic
for our aerospace
business. And it's
perfect for me."**

Mark Seidel, General Manager
Parker Gas Turbine Fuel
Systems Division
Parker Hannifin Corporation

In his 25 years with the company, Mark Seidel has managed three separate aerospace companies for Parker Hannifin. All three are headquartered in Ohio, which says a great deal about the strength of the state's aerospace industry. And about how Mark enjoys living in Ohio.

Currently General Manager of Parker Gas Turbine Fuel Systems Division, Mark works with aircraft engine manufacturers and airframe integrators around the world. Yet he's able to find all the necessary skills and supply chain elements he needs through nearly 800 quality suppliers right here in Ohio.

From outstanding engineers to skilled technicians, Mark also finds the top talent he needs, trained at Ohio's excellent universities, colleges and technical schools. It all contributes to an extremely healthy business environment for Ohio aerospace companies.

On the personal side, Ohio's diversity of people and places allows Mark to move from work to vibrant city nightlife to pristine, rural scenery to the quiet residential neighborhood he calls home, all within a short drive. And as an avid golfer and fisherman, Mark couldn't be happier with Ohio's world-class golf courses and abundant fishing opportunities.

For career and for life, Ohio gives Mark Seidel the balance he needs to succeed.

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The Job Markets Face a Stress Test

They pass, consumer spending—and the economy—will stay healthy

U.S. ECONOMY

After nearly 5½ years of steady growth, the U.S. economy is entering a delicate phase. So far, overall growth has slowed substantially without much impact on job growth. Indeed, March payrolls posted a strong gain of 180,000 jobs, and the employment rate dipped to 4.4%, matching the low point so far in

the business cycle, touched in October of last year. The next few months, however, could be tricky. What's at stake? Consumer spending, which has been the economy's primary support over the past year. Consumers have been of paramount importance to the economy's recent growth, and jobs and incomes have played the starring role in boosting household spending. Last year consumer outlays accounted for more than two-thirds of the growth in real gross domestic product. In the second half they contributed essentially all of it—profits and losses in other sectors balanced out to about zero. Much the same influence will be evident when the government reports its first estimate of GDP growth for the first quarter of 2007 on Apr. 27.

Job growth has already slowed, but not enough to ring alarm bells. In the first three months of 2007, monthly payroll gains averaged 152,000, down from 180,000 per month during 2006. The pace so far this year is still above the 100,000 to 125,000 per month that economists believe is sufficient to keep the employment rate edging lower. And household income from wages and salaries appears to have grown by close to 2% from the previous quarter, measured at an annual rate, which would imply a rise of about 4.5% from a year ago. That's much faster than inflation.

Over the next several months the labor markets will become increasingly vulnerable. Despite the resilience of consumers, overall demand in the economy has slowed, and job growth can often lag behind such shifts. Given that many businesses still find it difficult to recruit highly skilled workers, they appear hesitant to cut payrolls. The depth and duration of the demand lull becomes a concern. The longer the slowdown persists, the greater the chance that job growth will slow further.

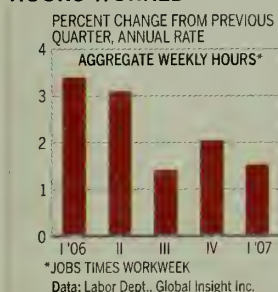
WHAT'S PARTICULARLY TRUE now that productivity growth is slowing sharply and tight job markets are driving up labor costs. Based on the expectation for a first-quarter economic growth of about 2% and the 1.5% drop in hours worked (chart), productivity last quarter managed to grow 1% or less. That tepid showing was a far cry from a quarter when workers' pay and benefits appear

to have risen some nine times faster. The combination is squeezing both profit margins and earnings growth, a situation that will make it increasingly difficult for companies to add workers if demand continues to ebb.

Managers already have become more reticent about hiring, according to the Conference Board's first-quarter Chief Executives' Confidence Measure. About 42% of the executives anticipate more hiring in their industry, down from 46% a year ago, while the proportion who expect fewer jobs rose to 32%, from 24%. The overall index of CEO confidence rose slightly, but the board's Lynn Franco says the uptick reflects "a decline in the number of pessimists, not an increase in the number of optimists."

THE MARCH JOBS DATA most likely exaggerated the labor market's strength last month. The weather, which

THE SLOWDOWN IN HOURS WORKED



was unusually harsh in February and more normal in March, clearly affected the numbers. The Labor Dept.'s tally of workers who said they were not at work because of bad weather posted an uncommonly steep rise compared with a typical February, followed by an exceptionally large decline in March.

For example, the payroll data say construction industries added 56,000 workers in March after shedding 61,000 in February. The truth is somewhere in the middle of those two extremes: Over the six months prior to February, monthly gains in construction payrolls averaged 3,000 workers.

A top concern for the coming months is that the big job losses expected in homebuilding have not yet shown up in the Labor Dept.'s data. That could change dramatically during the spring and summer building season. Labor's payroll data are seasonally adjusted, which means expected warm-weather increases in hiring are adjusted downward to get a better picture of the

underlying trend. If hiring in coming months fails to match the usual expectations, which seems probable, the seasonally adjusted data could register very large losses.

The surprisingly steep drop in new-home sales through February, including large downward revisions to the sales levels of recent months, implies a larger inventory of unsold new homes than earlier data had indicated. As a result, the ongoing declines in housing starts and overall residential construction will most likely turn out to be deeper and more protracted, with declines extending through spring and into summer.

It's not just inventories of new homes that are weighing on the labor markets. Falling demand for a broad range of items, from home-related consumer goods to construction equipment to building supplies, have caused backups in stockpiles at many businesses, which continue to depress output and hiring in manufacturing. Factory payrolls fell by 16,000 workers in March, about the same monthly pace of losses averaged since last summer.

THE GOOD NEWS from the job markets is that, at least so far, hiring weakness has not spread in any big way to areas outside of residential construction and manufacturing. In fact, construction employment apart from homebuilding is actually growing. Over the past year, jobs in residential building have fallen by 125,000, while other construction payrolls at business and heavy-engineering sites have increased by 146,000.

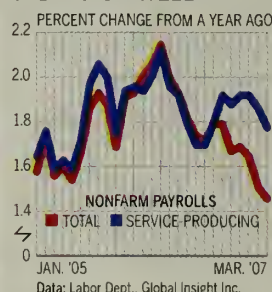
The area of greatest resilience in the labor market right now is the service sector, which accounts for

84% of all payrolls. Over the past year, job growth in services has slowed, but not as sharply as overall payroll (chart). What slowdown there has been concentrated in business services, such as legal, computer, and management consulting, along with financial services. Ground transportation has also slowed, along with

warehousing. Elsewhere, buoyant growth in information services, health care, leisure, hospitality, and retail trade has provided some offset.

Unless the weakness in housing and manufacturing spreads more pervasively through the service-sector job markets, consumer spending should remain

WHERE JOB GROWTH IS HOLDING UP WELL



buoyant, and the overall economy will be in a good position for a pickup in growth in the second half.

On that front, one key trend engenders optimism. At a similar point in the mid-1990s, when the Federal Reserve Board had stopped tightening monetary policy in February, 1995, after lifting its target rate from 3% to 6%, service-sector job growth had already fallen off sharply. The current pattern suggests that Fed rate hikes this time from 1% to 5.25%, have not been so constricting as to hammer overall employment. However, the next months should tell the tale. ■

BUDGET GAP

Strong Tax Revenues Slow the Red Ink

THE FEDERAL DEFICIT is defying expectations yet again. Tax revenues are growing at a stronger pace than many expected, and it now appears a slowdown in receipts will be gradual. That bodes well for the budget outlook.

Halfway through fiscal year 2007, the federal budget deficit stands at \$258.4 billion, nearly \$45 billion below the total through March of last year. Budget shortfalls are getting smaller because tax receipts remain quite strong. Through March, overall revenues are up 8% compared with the same six-month period in the last fiscal year.

The strong growth in tax receipts

witnessed in the past few years is unusual. Tax revenues haven't grown more than 8% for three straight years since a stretch in the late 1970s to the early 1980s. In the long run, receipts grow at about the same pace as the overall economy. Right now, however, the data don't suggest any such convergence will occur soon, says Lehman Brothers senior economist

Drew Matus.

The surprising gusher of revenues suggests that "tax rates haven't fallen as much as people believe," says Matus. One culprit is the Alternative Minimum Tax (AMT). Even though income tax rates were lowered earlier in this decade, the AMT appears

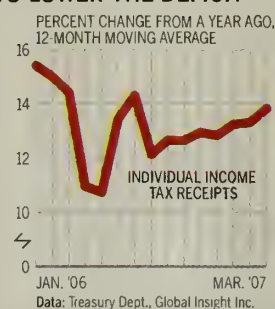
to have recaptured some of those potentially lost revenues despite yearly stopgap legislation to limit its bite. What's more, the AMT is capturing more taxpayers as income rises, which ends up raising the overall tax rate for American households.

A tighter labor market is also putting more money in Washington coffers. More jobs and larger wage gains mean more tax revenue. As long as the labor markets hold up, growing household receipts should help to offset any declines in corporate tax revenues from rising costs and softer profits.

Matus expects a continuing strength in receipts to help keep budget deficits close to \$200 billion through 2009. And with mounting pressure to reduce the country's military presence in Iraq, even smaller deficits may be possible. ■

—By James M.

HOUSEHOLDS ARE HELPING TO LOWER THE DEFICIT



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The Business Week

NEWS YOU NEED TO KNOW EDITED BY MICHAEL ARNDT AND HARRY MAURER



A TRADE SPAT HEATS UP

For years, Washington has been pounding the table to get Beijing to clamp down on piracy and counterfeiting. Now the **Bush Administration** has decided that jawboning just isn't enough. On Apr. 10 it escalated the fight by filing a pair of formal complaints with the **World Trade Organization**. The next day, China said the move will have "an unfavorable impact on bilateral trade."

Congress has been badgering the White House to take steps to narrow America's trade deficit with China, which swelled to \$233 billion last year. U.S. film studios, record companies, and book publishers have long griped that Chinese piracy translates into billions in lost sales (photo, counterfeit DVDs in Beijing). They also chafe at the mainland's market access restrictions, an issue addressed in one of the complaints. If Beijing and Washington don't hammer out their differences within the WTO-mandated 60-day consultation period, the U.S. may ask a WTO arbitration panel to weigh in.

ONLINE "U.S. takes piracy pushback to WTO," www.businessweek.com/go/tbw

Buffett Hops a Train

All aboard! Warren Buffett's Berkshire Hathaway said in an Apr. 6 filing that it's now the biggest shareholder of Burlington Northern Santa Fe, with a 10.9% stake worth more than \$3 billion, and has bought stakes in two other undisclosed lines. Railroads have delivered nine consecutive years of record freight shipments. BN's shares hit an all-time high of 93.22 on

Apr. 9, up 80% in two years.

ONLINE "Buffett's pricey railroad ride," www.businessweek.com/go/tbw

Economic Anxiety

Americans don't seem overly impressed by the health of the economy. Sure, the government said on Apr. 6 that the U.S. created 180,000 jobs in March, leaving the unemployment rate at just 4.4%. But a Bloomberg/

Los Angeles Times poll taken on Apr. 5-9 found that 60% of Americans think it's very or somewhat likely there will be a recession in the next year. Maybe it's those gas prices.

ONLINE "The economy: Why so gloomy?" www.businessweek.com/go/tbw

Citi Wields the Ax

Citigroup on Apr. 11 took the wraps off a cost-cutting plan

aimed at the bank's bloated expenses, which grew at twice the rate of revenues last year. Three months in the making, the plan calls for a 5% reduction of the bank's 327,000-person workforce. It will streamline layers of management and shift some jobs overseas. The first pink slips go out this week.

NASDAQ's New Flame?

Rebuffed by the London Stock Exchange, NASDAQ CEO Robert Greifeld is looking to hook up with the Philadelphia Stock Exchange, said *The Wall Street Journal* on Apr. 11. Philly, still ranked among the nation's top options bourses, would instantly put Greifeld within a couple points of his goal of taking a 20% share of the exploding options market by 2009 or so.

Biotech Brouhaha

Amgen, the biggest biotech, said on Apr. 11 that CFO Richard Nanula was leaving "to pursue other opportunities." This comes six weeks after the company acknowledged it was cooperating with an SEC investigation into its delayed disclosure of a Danish study on its Aranesp anemia remedy. Amgen stock has swooned 25% since October, largely because of safety questions surrounding Aranesp and its other anemia drug, Epogen. Nanula did not return calls.

Kerkorian Non Grata

DaimlerChrysler officials met with private equity bidders for Chrysler Group on Apr. 11 and 12, but Kirk Kerkorian's Tracim wasn't among them despite publicly offering \$4.5 billion. Kerkorian, who once sat on Chrysler's board, soured his relationship with the carmaker when he sued DaimlerChrysler and lost. He claimed the Germans misrepresented the

acquisition of Chrysler as a merger of equals." Daimler puts at least \$7 billion for Chrysler despite paying nearly \$1 billion for it in 1998.

NE See "Buyer beware at Chrysler," page 34

Biggest Buyout Ever?

A new twist on LBOs, a Canadian pension fund is trying to form a consortium that would mount a \$45 billion bid for BCE, the parent of Bell Canada, according to *The New York Times* on Apr. 10. If the Mario Teachers' Pension Plan succeeds, the deal could be the largest buyout in history. It's not clear whether private equity firms will join in, but Wall Street has signaled its approval by bumping up BCE stock 7.5%.

College Loan Scandal

New York Attorney General Andrew Cuomo continued to grab headlines worthy of his predecessor, Eliot Spitzer, as an fallout spread from the investigation into kickbacks in student loan providers. Cuomo, who began looking for perks given by commercial lenders to university financial officers last November, said on Apr. 11 he'd turned down far more such deals than expected. That followed news on Apr. 9 that CIT Group

put three top executives in its Student Loan Express unit on paid leave, and that Johns Hopkins University did the same to its financial aid director.

Pouncing on Puma

German sportswear maker Puma, known for its leaping-cat logo, could land in the closet of French group PPR, the owner of Gucci and other luxury brands. PPR bid \$7.1 billion for Puma on Apr. 10 after buying 27% from its two biggest shareholders. Puma's board supports a full takeover, and the deal could be wrapped up by summer. Sports shoes and \$5,000 handbags might seem an odd match, but Puma's cool styling is a hit with the young and hip—a crowd PPR longs to court.

ONLINE "Luxury giant aims to take Puma higher," www.businessweek.com/go/tbw

Baby Food Behemoth

On Apr. 11, *The Wall Street Journal* reported that Nestlé was expected to announce a \$5 billion deal to buy the Gerber unit from fellow Swiss company Novartis. Nestlé has long drooled over Gerber, which would give it nearly four-fifths of the U.S. baby-food market. Novartis would like to get Gerber off its plate to focus on the drug biz.

MOSTLY COMMENT OF THE WEEK

After making the latest in a long string of racially questionable comments, this one regarding Rutgers University's women's basketball team, veteran shock jock Don Imus was first suspended for two weeks by CBS and NBC Universal. Then, on Apr. 11, MSNBC said it would no longer simulcast the CBS radio show on cable TV. At press time no further actions had been taken by the networks, but key advertisers had begun rigging out of existing ad buys on *Imus in the Morning*. Among them, according to news reports: Procter & Gamble, American Express, and Staples. Bigelow Tea, said *The New York Times*, was reviewing whether or not to pull scheduled ads. A member of the Radio Hall of Fame since 1989, Imus, whose show has long been a favorite haunt of prominent Beltway politicians and media types, first began broadcasting in 1968. The *Times* says he pulls down an estimated \$10 million a year, and his show generates an estimated \$50 million in ad revenue for CBS, MSNBC, and their affiliates.



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GLOBAL CAPITAL

WHAT SPENDING SLOWDOWN?

Forget those antiquated government statistics. U.S. corporate investment is booming—just take a look overseas

BY MICHAEL MANDEL



1234



WHEN IS A slowdown not a slowdown? On the face of it, the government's statistics tell a very convincing story about cautious companies and weak business investment. For example, so far in 2007 new orders for nondefense capital goods, such as computers, trucks, and machinery, are barely higher than they were a year ago, an omen, perhaps, of tough times ahead for corporate profits.



So far in 2007, U.S. corporations seem to be keeping up the global spending pace. Alcoa Inc., which reported first-quarter earnings on Apr. 10, boosted capital spending by 32% over a year earlier, in part to fund the construction of the company's new smelter in Iceland, as well as investment projects in the U.S., Brazil, Russia, and China. And Boise (Idaho)-based Micron Technology Inc. spent almost \$1 billion more in the first quarter of 2007 than it did a year earlier: The semiconductor maker developed new plants in China and Singapore and expanded capacity at existing facilities in Virginia and Utah.

invested at home, and imports and exports were a relatively small portion of the economy. Even as corporations stepped out into the world, most of them still

Today, however, virtually every major company is trying to reduce costs and get closer to fast-growing markets by spreading manufacturing operations and research facilities around the world. As a result, a U.S.-centric view of capital spending, says Steven R. Appleton, CEO of Micron, is "almost meaningless."

STILL, IT'S HARD to wrap your mind around the implications of a world where U.S.-based companies make more and more of their investments overseas. Whether they are going abroad to chase customers or to seek out the skilled workers they need, American companies no longer depend on capital spending at home. "I don't have to hire one more person in the U.S.," says Appleton. "I don't have to invest one more dollar here—and we'll be just fine."

Appleton's sentiment is particularly striking, since Micron invested 100% of its capital spending domestically as



recently as the late 1990s. But plenty of other companies are making the shift abroad as well.

For example, 3M expects to spend about \$1.5 billion in cap-ex in 2007, up about 25% over last year. Out of 18 new plants or major expansions in the works, only seven are in the U.S. Four are brand-new facilities in China, with others in India, Korea, Poland, and elsewhere.

Or take Commercial Metals Co., an \$8 billion steel company based in Irving, Tex. In 2003 it bought a steel mill in Poland, where it makes wire rod and other products to sell in Eastern Europe, one of the hottest construction markets in the world. This fiscal year, says William B. Larson, chief financial officer, Commercial Metals will double its capital spending in Poland, helping drive a 49% increase in global capital spending in the company's second fiscal quarter, which ended in February. What's more, the company is currently bidding on two mills in Croatia and looking for more investments in Vietnam.

REALIGNMENT

IN SOME CASES, expansion overseas can coexist with increased investment at home. In 2006, Sealed Air Corp., a \$4 billion maker of Bubble Wrap and other packaging products, based in Elmwood Park, N.J., boosted capital spending by 73%, in part to fund projects in Brazil, Russia, and China. The goal, says CEO William V. Hickey, was to "align global production capabilities with growth." At the same time, however, the company's North American investment more than doubled.

What does all this mean? In part, the gap between the corporate and the government numbers may reflect differences in the sorts of companies being counted. The government estimate for capital spending covers all businesses, down to the corner grocery store. It also includes investment in the U.S. by foreign companies, such as Toyota, which can be big spenders. Moreover, the corporate numbers are subject to the vagaries of financial accounting, which tend to make government statisticians a bit leery of them.

But there's a bigger point here. In the

past there was a close link between the location of capital investment and jobs. When a company built a factory, that was where the jobs were going to be. In today's global economy, though, the link is not so clear. An expensive data center in Oregon, say, costing hundreds of millions of dollars, can support workers in India. An investment in database software in Texas can run a supply chain that starts in Taiwan. And new freight planes

bought in the U.S. by companies such as FedEx Corp. can help speed high-value exports from China.

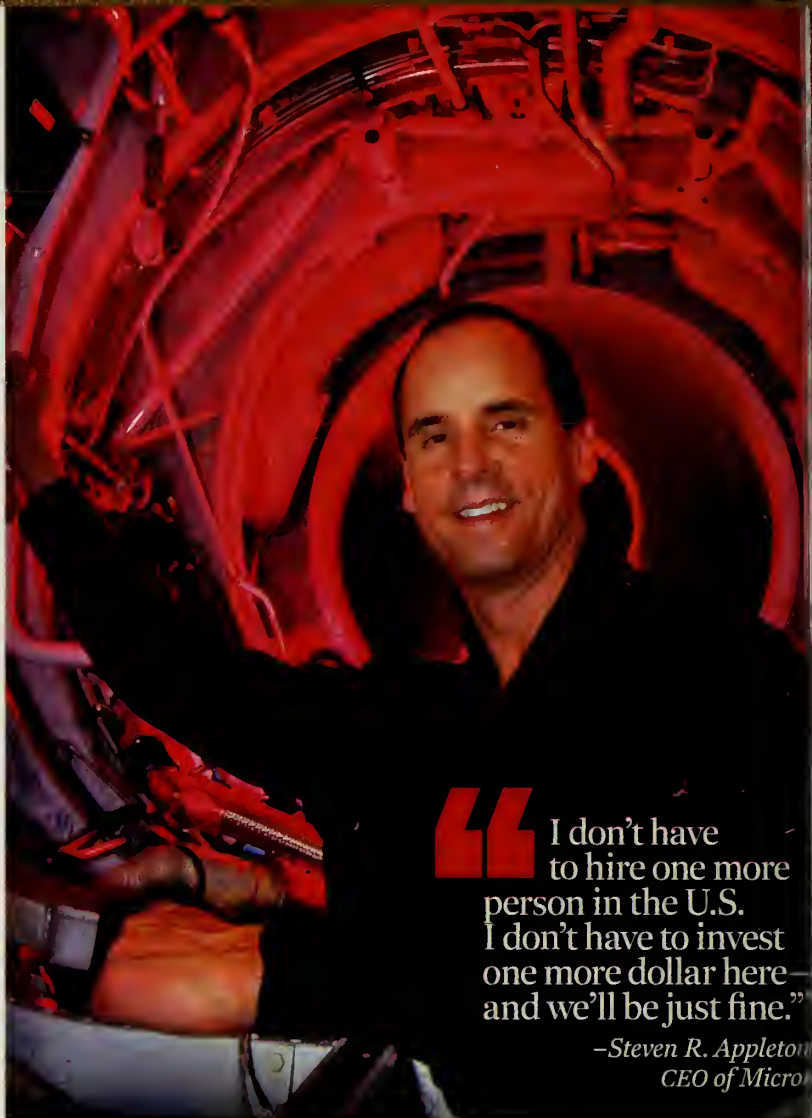
It's not even clear there's a close connection between the amount that companies spend in the U.S. and the health of the country's capital-goods makers. Twenty-five years ago, virtually all the equipment and machinery used by do-

mestic businesses were made in the U.S. In 1980 imports accounted for only 10% of domestic business spending on equipment and machinery, outside of trucks and cars.

Today imports equal 66% of U.S. capital spending on non-motor-vehicle equipment and machinery. Even more mind-boggling, exports of capital goods fit the country are just as big as the imports.

The bottom line: If a company is investing in the U.S., there's a good chance it's buying computers or some other piece of machinery made overseas. And if a piece of capital equipment, such as construction machinery, is made in a U.S. factory, there's a good chance it will end up being shipped abroad—perhaps even to help build a factory for a U.S.-based company that is expanding in another country.

If this all makes your head spin, you are not alone. The big divergence between domestic and global capital spending is a sign that the process of globalization has shifted into a new stage, and it's hard to know what's coming to come next. ■

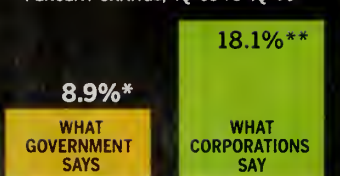


“I don't have to hire one more person in the U.S. I don't have to invest one more dollar here—and we'll be just fine.”

—Steven R. Appleton
CEO of Microchip Technology

TWO VIEWS OF CAPITAL SPENDING

PERCENT CHANGE, 4Q '05 TO 4Q '06



*DOMESTIC CAPITAL SPENDING BY ALL BUSINESSES OPERATING IN THE U.S. (NOT INFLATION-ADJUSTED)

**GLOBAL CAPITAL SPENDING BY COMPANIES IN S&P 1500 THAT HAVE REPORTED CAPITAL EXPENDITURE DATA (ADJUSTED FOR TELECOM MERGERS)

Data: Compustat, Bloomberg Financial Markets, BW

WAR CHESTS

AS POWER SHIFTS, SO DO THE DOLLARS

The Democrats are getting more PAC funds this election season

RICHARD S. DUNHAM

VENTURE CAPITALISTS have decided to plant their political seed money with Democrats this year after investing mostly in Republicans in 2006. Casino operators have switched their bets to the party likely to win power on Capitol Hill. And defense contractors are not staying the course: They've flipped from giving 62% of their donations to Republicans before the election to 67% to Democrats now. In the 2006 election cycle, business political action committees (PACs) gave 62% of their \$234 million in donations to Republicans. This year, though, corporate interests have rewarded Democrats for taking back control of Congress for the first time in 12 years by funneling 58% of their \$7 million in donations to them, according to an analysis of Federal Election Committee data by PoliticalMoneyLine. "Money flows power realignment," says Berlette A. Budde, senior vice-president of the Business Industry Political Action Committee. "We're telling [business] people, 'Be prepared to do business in a town that continues to look very different.'"

Among the businesses that have given a majority to Democrats this year after backing mostly Republicans in the 2005-2006 cycle: Aflac, Anheuser-Busch, Coca-Cola, General Dynamics, Viacom's Entertainment, Home Depot, Honeywell International, MGM MIRAGE, Miller Brewing, and United Technologies, which switched from 62% Republican to 59% Democratic after the election. Aflac spokesman James DeFrank says the change "reflects in part the new Democratic majority in Congress and changes in leadership on key committees." Lockheed Martin Corp. spokesman Jeffery Adams says his company's Democratic

contributions are "part of the ebb and flow of our overall budget within the election cycle." The Maryland defense contractor, which has given 62% of its donations to Republicans over the past decade, has contributed to 11 Democrats and 3 Republicans this year, including new Senate Armed Services Committee Chairman Carl Levin (D-Mich.).

It's not the first time companies have changed donation habits. When Republicans captured Congress from Democrats in 1994, GOP receipts from business PACs soared, from 49.9% before the election to 72% in the next campaign.

Most outfits deny they are opportunistic and say they've always tried

CAMPAIGN WATCH

to reward friends in both parties. "In any given year it may skew slightly to one party, but on average it balances out," says Mechell Clark, Aflac's media relations manager. Since 1979, 54% of Aflac's PAC money has gone to Republicans. It has given a majority to Democrats in 5 of the 14 previous election cycles, each time when that party controlled both houses.

TOO SOON TO JUDGE?

SOME COMPANIES caution against overinterpreting any trends. Home Depot has shifted its PAC contributions from 71% Republican in 2006 to 55% Democratic in 2007. But spokesman Ron DeFeo warns: "It is much too early to make judgments about the partisan balance of our giving."

DeFeo says the PAC is nonpartisan and supports candidates "who advocate policies that promote a favorable business climate for the Home Depot."

Of course, not every company has reversed gears. ExxonMobil, Halliburton, PricewaterhouseCoopers, and U.S. Bancorp have remained loyal to the Republican Party. ExxonMobil spokesman Gantt Walton says his company's contributions are "very, very consistent," no matter which party is in power. "We focus on candidates that are pro-business and want to strengthen the free-enterprise system." ■



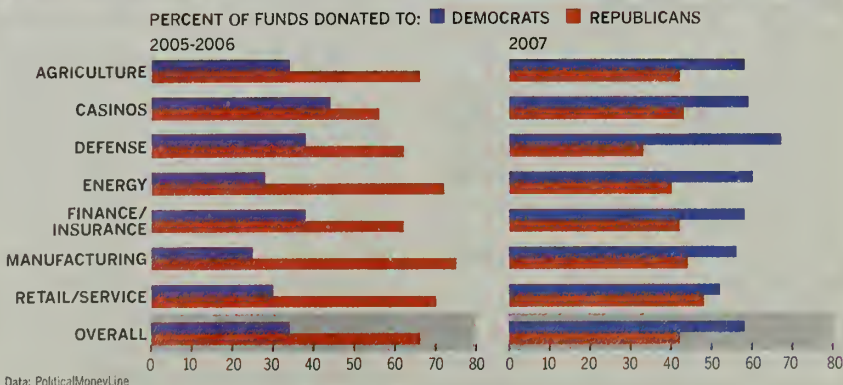
MARTINEZ

HOT AND NOT

Business PACs are switching allegiances from Republican National Committee Chairman Mel Martinez's congressional colleagues to Democratic National Committee Chairman Howard Dean's troops



DEAN





DUE DILIGENCE

BUYER BEWARE AT CHRYSLER

Whoever buys the carmaker Daimler is ditching won't get a stand-alone company

BY DAVID WELCH

WITH THE ENTRANCE of billionaire Kirk Kerkorian into the bidding for Chrysler Group, the struggling carmaker is starting to look like a hot property. But buyer beware. Whoever ends up purchasing the U.S. company from German parent DaimlerChrysler might find themselves a few parts shy of a complete car company.

If a deal gets done, the new Chrysler may prove the ultimate test case for outsourcing. Chrysler is far from being a turnkey company and lacks some of the most basic components of a successful automaker. Its new owners would either have to continue to rely on Daimler—which may keep a stake in Chrysler—or find new partners for such vital disciplines as research and development, engineering, even writing car loans. Tougher yet, Chrysler lacks economies of scale that rivals like Toyota Motor Corp. and General Motors Corp. enjoy by selling variations of the same car across the globe.

Winning the bidding war is just the beginning. The new owner of Chrysler will have to find innovative ways to make this small, regional company compete

like a big global one. “We did the merger with Daimler because we didn’t think we could make it on our own,” says former Chrysler President Thomas T. Stallkamp, now a partner with private equity firm Ripplewood Holdings. “If the merger is unwound, you have to find a new partner or partners to make it work.”

That’s the bad news. But in a perverse way, it’s also the good news. Sure, any of the bidders—which include Kerkorian, private equity firms Cerberus Capital Management, Blackstone Partners, Centerbridge Partners, and parts maker Magna International—will need to forge some key strategic links. But that gives a new owner the opportunity to rethink the

way Chrysler has managed itself. It could scrap some existing relationships to find new partners to develop cars, technology, and even purchase parts or cheap. Chrysler’s new owner could find creative ways to team up with carmakers that make mainstream models in a way that produces real synergies and saves billions. “If I’m one of these private equity players bidding on Chrysler,” David E. Cole, chairman of the Center for Automotive Research in Ann Arbor, Mich., says, “I’m talking to China Inc., I’m talking to GM, or any other automaker.”

PARTNERING UP

TO SEE HOW BADLY Chrysler needs new partners, look at its passenger-car business. The underpinnings of the popular 300 sedan came from Mercedes-Benz. The Dodge Stratus was a joint effort with Mitsubishi Motors Corp., which DaimlerChrysler’s partner for passenger cars until recently, developed the frame and structural components lie beneath Chrysler’s Dodge Caliber and Jeep Compass compacts and the Dodge Avenger and Chrysler Sebring midsize cars. A new Chrysler would have to either redevelop small and midsize engineering capabilities, or more likely find a new partner. Except for the Caliber, the new cars developed with Mitsubishi are also rans in a crowded market. Two decades of on-and-off ventures with Mitsubishi have produced few winners.

That means it’s time for Chrysler to pick a new partner, one with better engineering and even greater global sales volume than struggling Mitsubishi. And France’s PSA could be a candidate. So, too, are Korea’s Hyundai and Kia as well as Chinese carmakers. Chrysler already signed a deal to develop subcompacts with China’s Chery Automobile. The company needs other deals like that to offer cost-competitive cars.

A stronger partner could also l

The Missing Pieces

CRITICAL MASS By itself, Chrysler’s sales are too small to compete with the economies of scale enjoyed by GM and Toyota

KNOWHOW Under Daimler, Chrysler outsourced the core engineering work for compacts and family cars to Mitsubishi

FUTURE TECH Daimler handles most advanced R&D, leaving an independent Chrysler short on new technology

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Chrysler overcome one other big disadvantage: Its small size and overexposure to the U.S. Chrysler sells maybe 200,000 midsize cars a year—a fraction of what Honda, Toyota, and GM sell worldwide. Those giants spread costs over sales of 1 million to 2 million family cars, reaping huge advantages in parts-buying and factory use. That pays off development costs quickly and boosts margins. Add a partner like PSA or one of the Koreans, and they can combine sales to push down costs for parts, engines, and engineering work. That's something that Mercedes, whose luxury cars can't easily share parts with Chrysler vehicles, rarely gave its American partner.

Then there's the lending business. Daimler and Chrysler married their finance units thoroughly. A new owner could split out Chrysler's portion of the loan business. But the company would still need to set up back-office and underwriting operations, Stallkamp says. Daimler could keep the financial-services business and charge Chrysler fees for writing loans. Or Chrysler and Daimler could jointly run the finance company, but then they would have to share the profits—which are big on this side of

the business. One other possibility that could be a boon for Chrysler's buyer: The new owner takes all of DaimlerChrysler Financial Services and charges Daimler for loans.

Bigger challenges loom on the R&D front. Chrysler closed down its research unit in 2004, turning over

most advanced work in hybrid-electric cars and hydrogen fuel cell research to Daimler. Again, Chrysler could rely on Daimler for fuel-cell development and continue to use the GM-BMW-Daimler hybrid joint venture. That's no big deal—many companies are pairing up to share the expense of developing clean, fuel-efficient cars.

But there's the catch. Chrysler has a hybrid partnership, but it's one of the last carmakers to bring a hybrid to market. Daimler has 100 fuel-cell vehicles on the road globally, though most of them carry the Mercedes name. A new partner might work faster. In any case, says Stallkamp, "the Daimler merger answered a lot of questions for Chrysler. Now that it's going away, someone needs to answer those same questions." ■

Handled well, the obstacles could strengthen Chrysler

SEARCH ENGINES

FREE INFORMATION, PLEASE

Google is the latest to offer directory assistance, as phone companies squirm

BY OLGA KHARIF

MA BELL HAS YET another reason to be wary of Google Inc. The Web search leader is testing a free service that lets callers search for business listings from a landline or mobile phone by dialing 1-800-GOOG-411. Google will even connect the call and text the number to the user's cell phone—all for no charge.

Google, which already was dabbling in citywide Wi-Fi services, is one of several tech players that are swarming the \$8 billion-a-year directory assistance business. In March, Microsoft Corp. acquired Tellme Networks Inc., which provides automated directory assistance services to telcos like Cingular/AT&T. Tellme is testing a free 411 service of its own (1-800-555-TELL). Ultimately, says Daniel Phibbs, an analyst at the Pierz Group, free 411 may expand the market, pulling in callers who now resist paying an average of \$1.28 per 411 call over a regular phone line and \$1.57 via cell phone.

Free information services are made possible by short paid advertisements. At some point in the call, you may hear an ad to get McDonald Corp.'s latest happy meal or to check out CBS's latest episode of *CSI*. Advertisers see this as a chance to grab consumers at the point they're contemplating a purchase.

One of the more successful services, Jingle Networks Inc. (1-800-FREE-411),

has nabbed 5% of the directory assistance market in just a year after half of operating. Its advertisers include McDonald's, 1-800-FLOWERS, and Jingle says it has handled more than 1 million calls. The Menlo Park, Calif., company has yet to turn a profit, but had no apparent trouble raising funds from such investors as Goldman, Sachs & Co. and Comcast Interactive Capital, an investing arm of Comcast Corp., the largest U.S. cable provider.

Directory assistance is just one of the ways search engines like Google are bringing the Web to mobile phones. (They've served up a number, why

also shoot over directory assistance. To keep costs low, though, there can be trade-offs in quality. Some free 411 services, such as Google's, rely only on voice-recognition software rather than live operators and sometimes fail to complete calls, says Phibbs. Google's service hung up on a reporter requesting a number for a coffee shop in Portland, Ore.

15-SECOND ADS

STILL, BIG PHONE companies see the writing on the wall. In December, AT&T began testing its free 411 calling (1-800-555-5697) in three markets:

San Francisco, Calif., Oklahoma City, Okla., and Columbus, Ohio. Callers get listed for free in exchange for listening to 15-second ads, one at the beginning and one toward the end of their call. In coming months, the phone giant plans to expand the trial to other metropolitan areas, says AT&T spokesman Fletcher Cook. ■



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REGULATORS

THE GROWING REVOLT AGAINST THE SEC

A rising chorus of business groups is calling for dramatic accounting reforms

BY DAVID HENRY

CORPORATIONS ARE SUFFERING from a severe case of restatement fatigue. Last year 10% of public companies, some 1,244, had to correct their financials, up from less than 1% a decade ago. "Did all of these [companies] get it wrong because they were incompetent, lazy, or engaging in fraud?" says Robert C. Pozen, chairman of MFS Investment Management, a public mutual fund firm. "I don't think [so]."

Of course, management is blaming the onerous rules of the 2002 Sarbanes-Oxley Act (SarboX), which beefed up disclosure. But now companies also are blasting regulators. They contend officials at the Securities & Exchange Commission and others are capriciously reinterpreting rules or using ambiguous or inappropriate tests for problems—all of which has forced a flood of unnecessary

and costly restatements. As a result, the movement to lighten the SarboX burden has evolved into a broader push for dramatic accounting reforms.

Leading the charge are two prominent groups of business leaders, the Committee on Capital Markets Regulation, a group endorsed by Treasury Secretary Henry M. Paulson Jr., and the Commission on the Regulation of U.S. Capital Markets in the 21st Century, sponsored by the U.S. Chamber of Commerce. Advocacy group Financial Executives International has also joined the fray, calling for the Financial Accounting Standards Board, which sets principles for companies, to stop issuing new rules and instead simplify existing ones.

It's not clear how much power the groups will have to force change. Corporate misdeeds continue to surface. In March, Dell Inc. reported that it had discovered financial "misconduct." Some critics also question the merits of the groups' arguments and say some of the proposed changes could open the door for accounting shenanigans. Still, their voices are being heard. Amid the dissent, the SEC convened a special meeting on Apr. 4 to rein in SarboX.

Among the biggest complaints: SEC

rulemakers are recklessly handing new orders by fiat. The chamber's points to a 2005 letter from Don Nicolaissen, then the SEC's chief accountant. The groups assert it reinterprets accounting rules on leases. Nearly 80 restatements resulted—proof, they say, regulators run amok.

'WRONG WAY TO GO'

YET NICOLAISSEN says he only revised the standards and wrote the letter at the behest of corporate auditors. "The accounting literature has been in flux for a long time, but it wasn't being followed," says Nicolaissen, now retired.

The panels also take issue with a *Staff Accounting Bulletin*, a paper clarifying the SEC's views on disclosure practices. In it, the panels contend, the SEC threw out a "rule of thumb" in which errors that amounted to less than 5% of income are immaterial and don't have to be corrected. By doing so, the group says, the staff made the threshold too sensitive. One committee wants to establish a general 5% benchmark.

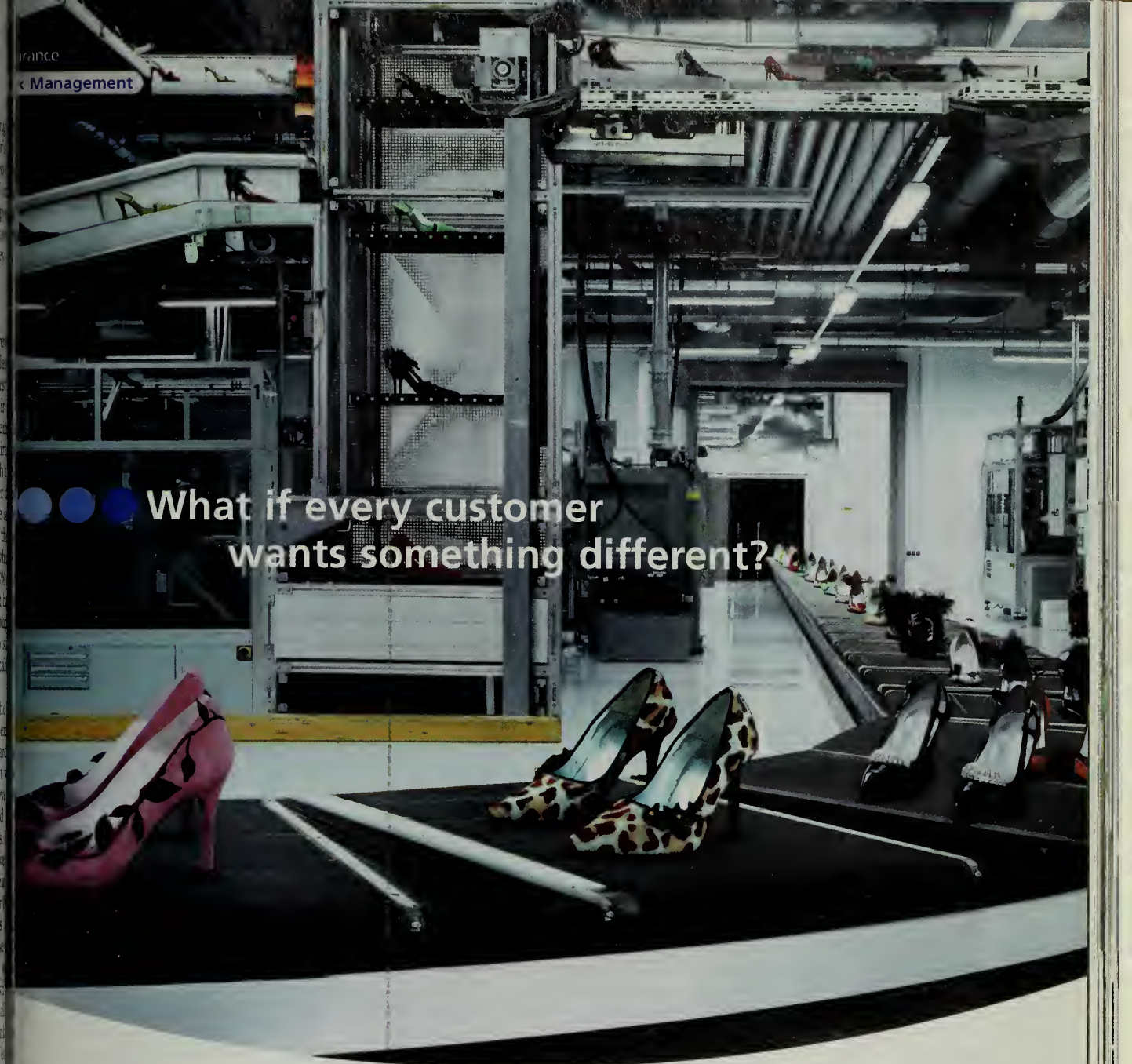
Critics of the SEC's rules—who say there have never been hard fast rules about what is material—believe the current standard would create more problems. "Companies have to hide their mistakes," says In 1998, former Fama executives took a book an expense of 4% of income on grounds it wasn't material. That all the top brass to bank

bonuses. Georgia Institute of Technology professor Charles W. Mulford, Jr., sanctioning a 5% test today "would be absolutely the wrong way to go. If you do that, and it's not right."

Meanwhile, investors aren't that concerned over restatements. Stock prices don't seem to have been hit after a correction now that the practice is more common. And companies see restatements as a good source of information. Says Neri Buksan, chief accountant for credit-rating agency Standard & Poor's: "Errors should be corrected."

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SATELLITE TV

THE BATTLE OF BRITAIN

For Richard Branson and James Murdoch, it's a war of attrition in telly programming

BY RONALD GROVER

IT'S A BLOOD FEUD that has Britain's tabloids in a predictable lather. On one side is flamboyant showman Sir Richard Branson of Virgin fame. On the other is the world's most powerful media baron's son, James Murdoch, the 34-year-old heir apparent to Rupert. They're slugging it out over Britain's increasingly competitive TV market.

Murdoch's British Sky Broadcasting Group PLC satellite-TV company has been the heavyweight in the country since the early 1990s. But last year, Branson and private equity investors combined a pair of bankrupt cable companies and merged them with Sir Richard's wireless provider. The new company, Virgin Media Inc., rolled out a low-cost package of TV, Web, and phone services, and the battle was joined. The latest flareup came in March when Murdoch & Co. said Virgin would have to pay more to carry popular Sky entertainment and news channels. "Sky clearly decided to take the gloves off," says media analyst Claire Enders.

Murdoch is playing rough because there's not a lot of room to grow in the 26 million home-TV market. The British are buying set-top boxes to get over-the-air digital signals from broadcaster Free-

view. Against that backdrop, the smaller Virgin lost cable subscribers in its most recent quarter, while Sky has cut some prices to reach its goal of 10 million subscribers by 2010, up from 8.3 million today. "To grow," says Enders, "Murdoch knows he has to take share from cable."

The opening salvo came last year when Virgin decided to bid for the right to air Premier League soccer games, which Sky has carried for years. Sky prevailed but was forced to pay more for fewer games. Not long after that, Murdoch, aware that Virgin was keen to buy commercial broadcaster ITV PLC, outbid his rival, acquiring a 17.9% stake for a pricey \$1.8 billion. It was a blow for Virgin, which wanted ITV's library of old TV shows to lure subscribers.

Branson, ever the provocateur, called for an antitrust investigation and labeled the acquisition "a blatant attempt to distort competition." Murdoch, who favors a more restrained public posture than Branson, dispatched his public relations minions to fire back: "Sir Richard seems

PROVOCATEUR to believe he and his partners have a unique right to acquire ITV."

British regulators are studying whether the Sky acquisition merits punitive action, but few believe the deal will be scotched. Besides, Sky already may have hobbled its rival when last year it slashed by 85% the rates Sky pays to carry channels owned by Virgin. "It was a take-it-or-leave-it deal," says Virgin CEO Stephen A. Burch, who says the cash-strapped company was forced to accept the offer because it had commitments to advertisers.

BRINKMANSHIP

NOW THE TWO COMPANIES may be headed to court. Branson's people say Sky wants to double what it charges Virgin to carry five Sky channels, which include hits like *The Simpsons* and *24*. Sky, which is required to offer the channels to all competitors, says it has spent more to get better programming and simply wants to be paid. "We're asking a fair price for a bigger and better package of channels," says Jeremy Darroch, Sky's chief financial officer, who adds that the fee increase amounted to only 19% when you strip out new digital services Virgin can decline. Talks broke down late last month, with Virgin threatening to sue Sky for abusing its market power. Meanwhile, Sky took the channels down and offered to set up a channel of missed shows for Virgin defectors.

A veteran executive at Comcast Corp. Burch is used to media brinkmanship. "Even [in the U.S.] someone usually gives in," says. "I didn't see any give the last time I talked with James." Nor, apparently, did Richard. He called Murdoch recently but didn't hear back. ■

—With Kerry Caplan in London

Why B Sky B is Playing Rough

Operating margins are falling

2006	2008*
21.1%	15.6%

Data: Bear Stearns

*projected

SCION Murdoch is charging more for Sky channels



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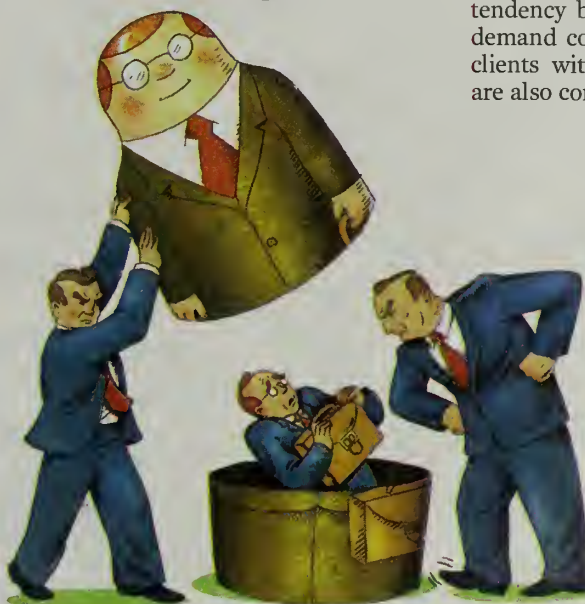
Former Yukos auditor PwC could face criminal charges in a politically tinged case

JASON BUSH

WITHOUT WARNING, Russian police raided a Moscow office building on Mar. 9, seizing box loads of documents. Such raids were common three years ago when authorities were investigating oil giant Yukos and its chairman, Mikhail Khodorkovsky, for tax evasion. This time, though, the target wasn't a Russian oligarch. It was the Moscow headquarters of Big Four accounting firm PricewaterhouseCoopers (PwC).

The raid on PwC is the latest sign of Russia's difficult legal environment for business. The police visit came four months after a Moscow court ordered the firm to pay \$15 million in back taxes and fines for alleged tax evasion in 2002. Police are now investigating whether criminal charges are justified, which could threaten PwC partners with jail sentences. In another case, a local court ruled on Mar. 20 that PwC had issued false audits for Yukos from 2002-04. (Yukos was convicted of evading \$27 billion in taxes from 2002-04. Khodorkovsky is currently serving a prison term.) The court called PwC "practically a participant in illegal tax schemes" at Yukos and confiscated its \$645,000 in audit fees.

PwC denies any wrongdoing and is ap-



pealing the Russian cases. "We believe we applied the best principles of our profession and we made reasonable judgments at that point in time," says Michael L. Kubena, PwC's managing partner in Moscow. Now the firm is awaiting a decision due in May on the renewal of its auditing license.

Is it all the start of a widespread crackdown? Probably not. "We see the situation as part of the process of doing business in this country," says Roger Munnings, CEO of KPMG in Russia. Most observers link PwC's problems to its Yukos work: Russia's case against the oil company captured worldwide attention, and many analysts considered it politically motivated because

the Kremlin viewed Khodorkovsky's influence as a threat. The charges against PwC coincide with Yukos' final breakup—its last assets are now being sold in auctions. And prosecutors filed new charges against former Yukos executives in February. "One should look at it as an individual case, not an attack on the whole auditing market," says Agvan Mikaelyan, deputy general director of accounting firm Finexpertiza.

Still, accountants and lawyers worry about the consequences of a new government effort to tighten financial monitoring. They complain of a growing tendency by Russian tax authorities to demand confidential information about clients without a legal basis. Auditors are also concerned about proposed legal

amendments that would require them to report potentially suspicious activity by their banking clients to the Central Bank. "I think the law enforcement organs want us to do their job for them," complains Julia Emelyanova, a partner at Russian accountancy BKR-Interkom-Audit.

Another problem is the fickle nature of Russian law. At the time of PwC's Yukos audits, the use of havens and other schemes to minimize taxes was widespread in Russia, and the law was ambiguous. Only

later were such schemes declared illegal and challenged retroactively in court. That has caused critics to complain about selective enforcement of Russian law. Even U.S. Commerce Secretary Carlos M. Gutierrez on a recent visit to Moscow called for fair treatment of PwC.

That may be small comfort for PwC's embattled Russian operation. But if the partnership's license is renewed, the firm should bounce back. PwC is Russia's No. 1 auditor, with 2,000 clients. Revenues last year rose 16%, to \$215 million. Says PwC's Kubena: "Our business continues to do incredibly well." ■

Trouble in Russia

Pressure is mounting on accounting firm PricewaterhouseCoopers

MAY 20, 2006

A Moscow court orders PwC to pay \$15 million in back taxes and fines

DEC. 25, 2006

Tax authorities file a suit against PwC, accusing it of preparing false audits for Yukos

MAR. 9

Russian police raid PwC offices in Moscow in a criminal probe into alleged tax evasion

MAR. 20

A Moscow court fines PwC \$645,000 for its auditing of Yukos from 2002 to 2004

APR. 3-9

Russian carmaker AvtoVAZ drops PwC as its auditor, but Gazprom rehires the firm

MAY 20

PwC's Russian auditing license, awarded five years ago, is up for renewal



AUTOMOBILES

THE RACE TO BUILD REALLY CHEAP CARS

The newest thing on four wheels is sturdy, inexpensive and probably not made in the U.S. **BY GAIL EDMONDSON**



HOW CHEAP IS CHEAP? Renault-Nissan Chief Executive Carlos Ghosn is betting that for autos, the magic number is under \$3,000. At a plant-opening ceremony in India Apr. 4, he was already taking up the industry's next challenge: a future model that would sport a sticker price as low as \$2,500—about 40% less than the least expensive subcompact currently on the market. Renault-Nissan is the first global automaker to take up the gauntlet thrown down in 2003 by India's Tata Motors, which plans to launch a \$2,500 car next year. Both are leading the race to the bottom that could affect the business every bit as much as Henry Ford's Model T did a century ago. After years of making their mass-market cars more expensive, the world's automakers have abruptly shifted into re-

verse. With stagnant growth in the U.S., Europe, and Japan, they are now eyeing emerging markets for new opportunities. That means redesigning the car for buyers who might otherwise be able to afford only a motorcycle. And outdated, stripped-down models won't do. Demand is surging for basic cars that combine modern comfort with safety at a fraction of today's cost. The rush to build a modern, no-frills car could do for autos what airlines like Southwest Airlines Co. and JetBlue Airways Corp. have done for travel, and H&M and Zara have done for fashion. Low-cost cars are "the single most important trend in the automotive industry today," says Vikas Tibrewala, the Paris-

ASIAN INVASION
Hyundais destined for export on the factory lot in India

based executive director of the Monitor Group consultancy.

Whatever the lowest sticker price turns out to be, the discounting trend will hit cars across the board, from minis to SUVs. Renault already has a runaway hit with its bare-bones Logan sedan. The automaker began offering the roomy Logan in Europe for just \$7,200 in 2004—some 40% less than rival sedans—and has since sold 450,000 of the cars in 51 countries. Workers at its sprawling Dacia plant near the Romanian city of Pitesti and a newer plant in Russia toil in round-the-clock shifts but still can't meet demand. "With the Logan we have the product and we have the lead," says Ghosn.

A \$3,000 car for Asian markets, built in low-cost India with a local partner, is the next logical step. "The main weakness of today's global automakers is that they are incapable of delivering a car that fulfills basic needs at a very low price," says Ghosn. "The people who have these skills are in India and China."

CUTTING COSTS TO THE BONE

THAT REALIZATION IS now dawning on the industry's giants. When Tata made its vow to build a \$2,500 car, many Western auto executives ridiculed the project, dubbing it a four-wheel bicycle. They aren't laughing anymore. Tata's model is a real car with four doors, a 33-horsepower engine, and a top speed of around 80 mph. The automaker claims it will even pass a crash test. And while the car probably won't win any beauty contests, it's no ugly duckling either, according to the handful of industry insiders who have been given a glimpse. The rest is top secret, but Tata engineers are already testing a prototype as the clock ticks toward a late 2008 launch.

The key is India's low-cost engineers and their prodigious ability to trim needless spending to the bone, a skill developed by years of selling to the bottom of the pyramid. "You have to cut costs on everything—seats, materials, components—the whole package," says Tata Group Chairman Ratan N. Tata.

There's no lack of potential customers: Hundreds of millions of Chinese, Indians, Brazilians, Russians, and others will likely join the middle class in the coming decade, and cars are sure to be at the top of their shopping lists. As a result, the global car market is polarizing: The luxury segment continues to grow, cheap cars boom, and everything else gets squeezed. By 2012, the market for vehicles priced under



CHURNING OUT
Logans in Renault's
plant in Dacia,
Romania

\$10,000 is likely to reach 18 million cars, or a fifth of world auto sales, according to Roland Berger Strategy Consultants. That's up from 12 million today.

So far this year, every major carmaker has announced its own 21st century Model T project. Toyota, Volkswagen, Fiat, and Peugeot have all vowed to build cut-rate Logan-killers. General Motors Corp. intends to use its Korean subsidiary, GM Daewoo, to design a model that will sell for about \$7,000. Chrysler is developing low-cost cars with Chinese manufacturer Chery. Korea's Hyundai Motor Co. is making India its global hub for small-car production and expects to double its output to 600,000 cars annually by yearend, many of them destined for Europe. "Automakers will have to live with a trend of lower-cost vehicles. It

is difficult but that's where the demand is," says David Nicholas (Nick) Reilly, president of GM Asia Pacific. The average retail price for many compacts will probably sink to \$9,000, while minis will go for around \$7,000, Reilly predicts. That's about 15% below current model prices.

Car manufacturers, of course, have always sought to cut costs and pack more value into each new-model generation to stay competitive. But now, emerging markets like India offer cheap engineering, inexpensive parts-sourcing, and low-cost manufacturing. For its new car, for example, Tata should be able to slash the cost of the engine to about \$700, or 50% lower than a Western-developed equivalent, says one consultant close to the company. Combine Indian brainpower with Western innovation in design, materials, and processes, and

the potential exists for a quantum leap in cost-reduction without major sacrifices in quality. Tata and Renault's Indian partner Mahindra & Mahindra Ltd. already doing engineering work for global automakers at cut-rate prices. Tata, for example, is working on a coupe for a major Western customer.

LESSONS FOR BIG CARS

ANOTHER NEW FACTOR in the low-cost car segment is the possibility of huge volumes that can drive profits. Ultra-cheap cars historically have not sold in large numbers. In 2005, low-cost cars represented less than 1% of new-vehicle sales in the U.S., according to Roland Berger. By contrast, emerging markets, which held little appeal for the major car brands even 10 years ago, now offer a volume bonanza that can make even cheap cars profit spinners. In India alone, some 10 million motorcycle and scooter riders are likely to buy a car over the next five years, the Berger study estimates. India's auto market is set to double to 3.3 million cars by 2014, while China's will grow 14% over the same period, to 16.5 million cars, according to J.D. Power Automotive Forecasting. That kind of demand makes dirt-cheap cars viable. "The real trick is the idea behind the low-cost segment is to increase volume as much as possible while bringing costs down," says Alfredo Altavilla, CEO for Fiat Powertrain Technologies (Fiat signed a technical partnership with Tata Motors in February.)

What automakers learn from experimenting with discount cars may shape how more expensive models are made. To make a success of the Logan, Renault manufactured in low-cost Romania. It developed a design that reduced the total number of parts and made assembly a cinch. It stripped out sophisticated electronics, dispensed with high-tech curved windshields, and even saved \$3 per vehicle by using identical rear-view mirrors on each side. The biggest breakthrough, Renault was able to eliminate expensive prototypes and the pricey tooling involved

in building them. As a result, it could move directly from digital mockup to production, an innovation that saved the French car company \$40 million. Now Renault has figured out how to eliminate physical prototypes of all its models.

Toyota is working on a bottom-of-the-line car with an expected sticker price of under \$7,000 that could

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markets can
make dirt-
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hit emerging markets such as India and Brazil by 2009. Toyota's management is banking on breakthroughs in new materials, manufacturing, and low-cost factories. If the Japanese company's engineers do their job, the cost-saving strategies will be deployed in everything from Corollas to Lexus SUVs. "When I asked for the low-cost development project two years ago, I wanted to see technology that would be applied to other vehicles as well," says Toyota President Katsuaki Watanabe. A prototype is expected this spring. A successful Toyota venture in this segment could "scramble all the eggs in emerging markets," says Fiat's Altavilla.

WHAT'S AT STAKE

TO AUTOMAKERS' astonishment, cheap cars are also proving to be just as popular in established markets as they are in the developing world. Renault originally expected to sell the Logan only in Eastern Europe and other emerging markets. But in 2005, the automaker started offering it across Western Europe. Buyers have flooded showrooms to get behind the wheel of the no-frills model. Yesterday's cheap cars (remember the laughably bad Yugo?) failed to take off in the West because of

poor quality. The new generation of cheap cars will be sturdy and reliable and will appeal to Western consumers who want to spend money on things other than transport. "It's all about price for performance," says Frankfurt music teacher Elmar Kolle, who in November replaced his Ford Mondeo with a marine-blue Logan sedan. "I'd have to pay 5,000 euros [\$6,500] more for a comparable car" from another manufacturer.

The shift to cut-rate wheels is jarring for an industry that has fixated for at least a decade on premium cars and their fat margins. BMW earns an estimated \$3,300 per car on average, vs. Logan's \$400 per car, according to Ferdinand Dudenhöffer, director of the German Center for Automotive Research. And when you get down to a sub-\$3,000 sticker price, some experts say it'll be tough to cover the cost of the parts involved. "Any way you look at it, it will be difficult to be profitable," says David Cole, chairman of the Center for Automotive Research in Ann Arbor, Mich.

Many cars in India are sold without airbags or antilock brakes

So why bother? Western automakers who don't jettison the fray risk being shut out of the growth in emerging markets. Even worse, they could give ambitious challengers a dangerous foothold in the West—not unlike the one they gave the Japanese by ignoring their low-cost, fuel-efficient models in the 1970s. China's Ge makes a model for \$3,900

and it's aiming to export a car to the U.S. by 2010. Suzuki Motor Corp., which sells cars starting at \$4,400 in India, will launch a new compact in 2008 and export it to Europe. Tata's \$8,500 Indi compact sedan already sells in southern and eastern Europe. "The Chinese and Indians are coming," says Patrick Pelachier, chief of strategy and product planning at Renault. "If we don't do our job, we will give them a huge slice of market share. We have to keep moving."

The majority of low-cost cars will range from \$5,000 to \$10,000, depending on size and features. Analysts say adding equipment required for safety and emissions control in Western markets would automatically bring the price of a cheap Chinese or Indian car up to \$6,000 to \$7,000. Many cars in India, for example, are sold without airbags or antilock brakes, standard features in the West. "There is a huge cost element to safety," says Hormaz Sorabjee, editor of *Autocar India*, noting that crash-test facilities alone are a gigantic investment.

Still, India remains the chief test bed and battleground for really cheap cars. Hyundai uses its plant outside Chennai as a global hub for its small-car production. By tapping local suppliers and manufacturing, the Korean upstart is able to offer a popular entry-level subcompact, the Santro, at a starting price of \$6,300 in India, while still making features such as air conditioning and power steering standard. Moving along the pristine high-tech production lines of its Chennai plant are also cars for export to Europe, Russia, and Latin America. Outside the plant, a vast sea of new cars, some 65% of them earmarked for export markets, fills Hyundai's orderly lots. "My only problem," says Lheem Heung-Soo, managing director of Hyundai India, "is limited capacity." He's ramping up production fast: So are all his rivals. ■

—With Ian Rowley in Tokyo, Nand Lakshman in Mumbai, David Welch in Detroit, and Dexter Roberts in Beijing

How Low Can You Go?



« **HYUNDAI** Chose India as its global hub for small-auto production; expects to double plant capacity to 600,000

TATA MOTORS Plans to unveil the world's cheapest car, costing roughly \$2,500, by yearend 2008

TOYOTA Working on a sub-\$7,000 car for emerging markets, likely to be built in India or Brazil

« **SUZUKI** Its sub-\$10,000 offerings make it India's leader, with 44% of the market; already exports to Europe

CHRYSLER Inked alliance with China's Chery to develop cheap cars for Chrysler and Dodge

VOLKSWAGEN Developing a car based on its Polo subcompact to compete with the Logan from Renault

GM Building low-cost cars in Korea; may use Chevrolet brand for a cut-rate car to launch in emerging markets in 2010

« **RENAULT** Pioneered segment with the \$6,000 Logan built in Romania; now rolling out global production



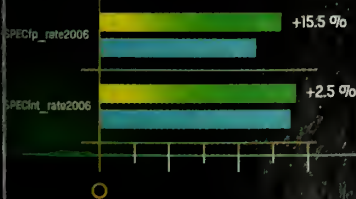
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BEVERAGES

THE GREAT INDIAN BEER RUSH

Locals disdain suds, but foreign brewers are betting they'll switch to the stuff

BY NANDINI LAKSHMAN

INDIANS LOVE THEIR BOOZE, but beer, it seems, leaves them cold. The country ranks tops globally in consumption of whisky, but it's somewhere near the bottom in beer drinking. So why is just about everyone in the brewing industry scrambling to get a piece of the market?

Despite the obvious preference Indians have for distilled spirits, beer makers worldwide think there's great potential for selling their brews in the country. A hot climate, an even hotter economy, and an enormous youth population look like an unbeatable combination in the eyes of Britain's SABMiller and Scottish & Newcastle, Heineken of the Netherlands, and Denmark's Carlsberg. Facing flat sales in many Western markets, all have set up India operations in recent years, either on their own or in tieups.

The latest to join the fray is Anheuser-Busch Cos. The No.1 American beer maker has just inked a 50-50 joint venture with local player Crown Beers. In May, the two plan to start churning out Budweiser and other brands at a new brewery in the southern Indian city of Hyderabad. "India is still pretty small," says Stephen J. Burrows, CEO of An-

heuser-Busch International. "But it has great potential."

Pretty small is putting it mildly. Although India boasts the world's second most populous nation, when it comes to beer it barely figures on the map—leaving plenty of upside for brewers who can get in early. Annual per capita consumption stands at just 0.6 liters, or about a pint, compared with 23 liters in China, an average of 73 across Europe, and 78 in the U.S. "Why should I waste money on beer when whisky does the trick much faster?" says Sudnya Bordoloi, a 21-year-old saleswoman at a Mumbai department store.

Getting Indians to switch from liquor to beer won't be easy. Brewers must contend with a dizzying list of bureaucratic restrictions that make it tough and expensive to win customers and to build a national footprint. Steep tariffs render imports uncompetitive. And state excise taxes of as much as 150% can

JUST TRY IT
Indian annual per capita beer consumption is a single pint

push the price of a pint of domestic beer up to more than 10 times as much as a shot of local whisky might cost. "The market has huge complexities," says Jean-Marc Delphon de Vaux, managing director of SABMiller India. "You have to work it bottom-up, state by state."

Ads for beer are banned. As a result, brewers have to be creative in building their brands on a national scale. SABMiller, for instance, sells a mineral water called Royal Challenge—not coincidentally the name of one of its lagers. The spots for the water are indistinguishable from traditional beer ads, down to the label on the bottle. The only difference: The actors guzzle a clear liquid rather than amber-colored suds. "It looks like a beer ad, but we sell water," says Delphon de Vaux. The boldest ploy, though, comes from Bangalore-based United Breweries. Its chairman, Vijay Mallya, launched Kingfisher Airlines—named after United's flagship brew, India's top seller—emblazoned the planes with its logo.

In short, international brewers will be charged with crafting a beer culture in India largely from scratch. In that, at least, they have demographics in their favor. Roughly 60% of the population is under 30. What's more, incomes are rising, powered by an economy that's growing at 9%-plus. These trends are expected to fuel growth in beer consumption of up to 10% a year through the end of the decade.

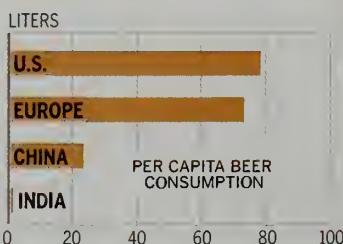
To date, the biggest beneficiary of the surge has been Kingfisher. The brand runs the market, with a 45% share. But closing in is SABMiller, which

over the past six years has spent an estimated \$600 million in India to buy 11 local breweries. Today, the company's five brands command 37% of the market. And Heineken, though it's small today, is hoping to boost its profile by lowering its \$18 million purchase last year to a controlling stake in India's Aurangabad Breweries Ltd. "India," says Vijay Chhabra, Heineken country chief, "is a place to be."

—With Adrienne Carter in New York



BOTTOMS UP



Data: Canadian Global Reports



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FEAR *of* FIRING

How the threat of litigation is making companies skittish about axing problem workers

BY MICHAEL OREY

Illustrations by Owen Smith

WOULD YOU HAVE DARED FIRE Hemant K. Mody? In February, 2003, the longtime engineer had returned to work at a General Electric Co. facility in Plainville, Conn., after a two-month medical leave. He was a very unhappy man. For much of the prior year, he and his superiors had been sparring over his performance and promotion prospects. According to court documents, Mody's bosses claimed he spoke disparagingly of his co-workers, refused an assignment as being beneath him, and was abruptly taking days off and coming to work late.

But Mody was also 49, Indian born, and even after returning from leave continued to suffer a major disability: chronic kidney failure that required him to receive daily dialysis. The run-ins resumed with his managers, whom he had accused flat out of discriminating against him because of his race and age. It doesn't take an advanced

degree in human resources to recognize that the situation was a ticking time bomb. But Mody's bosses were fed up. They axed him in April, 2003.

The bomb exploded last July. Following a six-day trial, a federal court jury in Bridgeport, Conn., found GE's termination of Mody to be improper and awarded him \$11.1 million, including \$10 million in punitive damages. But the award wasn't for discrimination. The judge found those claims so weak that Mody wasn't allowed to present them. Instead, jurors concluded that Mody had been fired in retaliation for complaining about bias. GE is seeking to have the award overturned, and a spokesman said, "We feel strongly there is no basis for this claim." Through his attorney, Mody declined to discuss the case with *BusinessWeek*.

If this can happen to GE, a company famed for its rigorous performance reviews, with an HR operation that is studied worldwide, it can happen anywhere. It has never been easier for U.S. workers to go to court and





allege that they've been sacked unfairly. Over the past 40 years federal, state, and local lawmakers have steadily expanded the categories of workers who enjoy special legal protection—a sprawling group that now includes women, minorities, gays, whistleblowers, the disabled, people over 40, employees who have filed workers' compensation claims, and workers who have been called away for jury duty or military service, among others. Factor in white men who believe that they are bias victims—so-called reverse-discrimination lawsuits—and “it’s difficult to find someone who doesn’t have some capacity to claim protected status,” observes Lisa H. Cassilly, an employment defense attorney at Alston & Bird in Atlanta.

THESE WORKERS WIELD A POTENT WEAPON: They can force companies to prove in court that there was a legitimate business reason for their termination. And once a case is in court, it’s expensive. A company can easily spend \$100,000 to get a meritless lawsuit tossed out before trial. And if a case goes to a jury, the fees skyrocket to \$300,000, and often much higher. The result: Many companies today are gripped by a fear of firing. Terrified of lawsuits, they let unproductive employees linger, lay off coveted workers while retaining less valuable ones, and pay severance to screwups and even crooks in exchange for promises that they won’t sue. “I’ve seen us make decisions [about terminations] that in the absence of this litigious risk environment, you’d have a different result,” acknowledges Johnny C. Taylor, Jr., head of HR at IAC/InterActiveCorp, the conglomerate that runs businesses such as Match.com and Ticketmaster.

MANAGERS OFTEN FAIL TO BUILD A CASE FOR FIRING BY SHYING AWAY FROM REGULAR AND CANDID EVALUATIONS

The fear of firing is particularly acute in the HR and legal departments. They don’t directly suffer when an underperformer lingers in the corporate hierarchy, but they may endure unpleasant indirect consequences if that person files a lawsuit. Says Dick Grote, an Addison (Tex.) talent management consultant: “They don’t get their bonuses based on the number of lawsuits they win. They get their bonuses based on the number of lawsuits they don’t get involved in.”

This set of divergent incentives puts line managers in a tough position. When they finally decide to get rid of an underperforming slob who plays PC solitaire all day in his cubicle, it can be surprisingly tough to do. And that, in turn, affects productive workers. “Few things demotivate an organization faster than tolerating and retaining low performers,” says Grant Freeland, a regional leader in Boston Consulting Group’s organization practice.

But it’s often the supervisors themselves who bear much of the blame when HR says someone can’t be shown the door. That’s because most fail to give the kind of regular and candid evaluations that will allow a company to prove poor performance if a fired employee hauls them into court. Honest

13

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harsh, reviews not only offer legal cover, but they're also critical for organizations intent on developing top talent. "There were definitely a lot of situations where a supervisor got fed up with somebody and wanted to terminate them, but there's no paperwork," says Sara Anderson, who worked in HR at Perry Ellis International and Kenneth Cole Productions Inc. in New York. Frequently, the work that the manager suddenly claims is intolerable is accompanied by years of performance evaluations that say "meets expectations." Says Anderson: "You look in the file, and there's nothing there to prove [poor performance], so it's like it didn't happen."

WHEN MODY SIGNED GE'S JOB application in 1998, the form said his employment was "at will" and "the Company may terminate my employment at any time for any reason."

Well, not exactly.

The notion that American workers are employed "at will"—meaning, as one lawyer put it, you can be fired if your manager doesn't like the color of your socks—took root in the laissez-faire atmosphere of the late 19th century, and as an official matter is still the law of the land in every state, save Montana. The popular conception of at-will employment is exemplified by the television show *The Apprentice*, which features Donald Trump pointing a finger at an underling and ousting him or her on the spot. That dramatic gesture makes great television, but it isn't something that happens very frequently anymore in the American workplace.

The rise of unions was the first development to put a check on summary dismissal. Collective-bargaining agreements outlined the specific kinds of infractions that could lead to termination, and set up procedures for discipline and review that a company must follow before a worker can be fired. But unions generally didn't deal with the problem of discrimination, and in some cases perpetuated it.

For most American workers now, their status as at-will employees has been transformed by a succession of laws growing out of the civil rights movement in the 1960s that bar employers from making decisions based on such things as race, religion, sex, age, and national origin. This is hardly controversial. Even the legal system's harshest critics find little fault with rules aimed at assuring that personnel decisions are based on merit. And most freely acknowledge that it is much easier to fire people in the U.S. than it is in, say, most of Western Europe. Mass layoffs, in fact, are a recurring event on the American corporate scene. On Apr. 17, for example, Citigroup Inc. announced it will

Untouchable Nation

Fired workers who fall into a protected category have special legal status. These days, it's harder than you might imagine to find an American worker who wouldn't fall into one—or sometimes several—of these categories.

shed some 17,000 workers.

Yet even in these situations, RIFs (for "reduction in force") are carefully vetted by attorneys to assess the impact on employees who are in a legally protected category. And these days the majority of American workers fall into one or more such groups. Mody, for example, belonged to three because of who he was (age, race, and national origin) and two more because of things he had done (complained of discrimination and taken medical leave). That doesn't mean such people are immune from firing. But it does mean a company will have to show a legitimate, non-discriminatory business reason for the termination, should the matter ever land in court.

As it happens, the judge in Mody's case tossed out his discrimination claims. But the retaliation allegation did go to jury—a development that is increasingly blindsiding business. Plaintiffs are winning large sums not because a company discriminated against them, but because the company retaliated when they complained about the unproven mistreatment.

The rules surrounding retaliation may sound crazy, but they are one of the big reasons why the fear of firing is so prevalent. Retaliation suits are a hot growth area in employment law. In 2005 and 2006, retaliation claims represented 30% of all charges individuals filed with the Equal Employment Opportunity Commission, a required first step before most discrimination cases can go to federal court. That's up from about 20% just years ago. "Even if there isn't a good discrimination claim, an employee has a second bite at the apple," notes Martin W. An

eye opener

ZZZZZZ ...



Total labor force
151.4 million

■ Minorities (31%)

■ 40 and over (52%)

■ Female (46%)

■ Unprotected*:
White males under 40 (16%)

***But not if the employee is:**
Disabled, gay, a whistle-blower,
a veteran, foreign-born, called
for jury duty, a workers'
compensation claimant

Data U.S. Bureau of Labor Statistics, 2006

of defense firm Edwards Angell Palmer & Dodge in Short Hills, N.J. Last year the U.S. Supreme Court increased the legal risk to business by ruling that improper retaliation can involve acts far short of firing or demoting someone. So even excluding an employee from meetings, relocating his or her office, or other intangible slights could lead to liability.

Of course, prohibitions against retaliation exist for a good reason. Without them, many workers would find it too easy to come forward with even legitimate complaints. Yet defense attorneys are deeply suspicious that some workers abuse the protection. Fearing their jobs may be in jeopardy, they may quickly contact HR with an allegation of discrimination or call the corporate hotline to report misconduct, thereby cloaking themselves in the protection of anti-retaliation law. "That's a fairly common fact scenario," says Mike Delikat of Orrick, Herrington & Sutcliffe in New York, a law firm that represents businesses. "The best defense is a good offense."

AFTER 1991, WHEN CONGRESS ALLOWED punitive damages and jury trials in job discrimination cases, litigation in the area exploded. In 2006, 14,353 employment cases were filed in federal court, up from 8,273 in 1990, though down from a peak of 20,955 in 2002. It should be noted that these statistics, which include both unlawful termination cases and other types of claims, dramatically understate the

frequency with which companies deal with these issues. For every case that's filed in court, several more are quietly settled well beforehand.

Many of the lawsuits may seem ridiculous. IBM is currently defending a case filed by James C. Pacenza, a plant worker it dismissed for visiting an adult Internet chat room while on the job. In his lawsuit, Pacenza claims that his propensity to such behavior stems from post-traumatic stress disorder, which he suffers as a result of military service in Vietnam, and that IBM violated the Americans with Disabilities Act. He also alleges that two other employees who had sex on an IBM desk were "merely transferred," so he was treated with undue harshness. Pacenza's attorney, Michael D. Diederich Jr., says his client "didn't violate any of IBM's policies regarding computer usage."

Even when employers beat back silly suits, it often doesn't feel like much of a victory. That's because meritless cases can still tie up companies in burdensome and expensive proceedings for years. In October, 2002, Southview Hospital in Dayton fired Karen Stephens, a nurse who worked in a unit for premature babies and other at-risk newborns. Six other nurses had reported that Stephens was abusive to infants, according to court filings, spanking them when they were fussy, wagging their noses until they screamed in pain, pinching their noses shut to force-feed them, and calling them "son of a bitch." Stephens, who was 60 at the time, sued Kettering Adventist Healthcare Network, which operates Southview, denying "inappropriate" conduct and alleging that the real reason she was let go was age discrimination.

Only after a year and a half of legal dueling did a federal district judge in Dayton toss out Stephens' claims in April, 2005. But then she appealed, and it took another year—and an additional round of legal briefing—before the U.S. Court of Appeals for the Sixth Circuit upheld the dismissal, noting that "Stephens has offered no evidence to indicate that she did not mistreat the infants," or that Kettering did not have a "legitimate, nondiscriminatory reason for discharging her." Kettering declined to comment on the case. "I never lost a baby in 25 years," Stephens said in an interview.

The cost and distraction of lawsuits lead many employers to engage in contortional, and at times perverse, litigation avoidance. Defense attorney Cassilly offers the story of one of her clients, a hospital in the Southeast forced to reduce its ranks because of budget cuts. The head of one department elected to let go a female employee in favor of keeping a more junior male, whom he had spent a great deal of effort to recruit and whom he felt was more valuable. But the hospital overrode that choice and laid off the man out of concern that

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it would be more exposed in a lawsuit by the woman.

Another of Cassilly's clients, a manufacturer, acquired a new facility and quickly identified one worker as having "a variety of performance problems." But the woman, an African American, had nothing in her personnel file indicating prior trouble, which made firing her a risky bet. So the company put her on a six-month "performance improvement program" to document her deficiencies—and to find out if she could mend her ways. She couldn't, and, Cassilly notes, her client "had to suffer through her poor performance during the whole period."

Early this year, Cassilly got a call from the client. They had just discovered that the woman, an office administrator, had stolen thousands of dollars from the company, and they promptly dismissed her. "It was almost a case where the company was delighted to find out they were the victim of theft," Cassilly says, as opposed to having to defend far more subjective performance evaluations.

Even in the face of theft, Revolution Partners, a small investment banking advisory firm in Boston, balked before showing one of its employees the door. The woman had used her company credit card for a personal shopping spree and plane ticket, but Revolution retained an employment attorney, got the woman to sign a form waiving her right to sue for wrongful dismissal, and after she was fired took no legal action to recover the amounts improperly charged. "We're a little firm, and the last thing I need is to spend a lot of time on a lawsuit, whether it's warranted or not," says Peter Falvey, one of Revolution's co-founders.

Falvey isn't alone. A number of defense attorneys and HR managers said companies they work for prefer to buy themselves peace of mind over facing the prospect of being sued. "They don't want the publicity or the expense," says Robert J. Nobile, an attorney at Seyfarth Shaw in New York. "Some of them say, 'Hey, we'll swallow our pride and pay 10 grand now rather than 100 grand later.'" That's an approach that makes IAC's Taylor shudder. "If that becomes your norm, then you train the plaintiffs' bar and your departing employees that they should expect something on the way out, no matter how poorly they perform," he says.

MANY OBSERVERS PUT MUCH OF THE blame for fear of firing on HR. "The problem is much more with HR managers being nervous Nellies than it is a problem in actual legal exposure," says consultant Grote. The bigger risk is retaining poor performers, not terminating them, he says, provided the firing is done properly.

Indeed, at most companies HR is essentially a support function that gets called in only when a personnel problem

For Every 10,000 Lawsuits, Few Losses, but High Cost

The maneuvering companies engage in to avoid wrongful-termination lawsuits is out of proportion to the risk of actually losing in court. One big reason: the high cost of litigating claims, even the ones that end up with the company winning.

Out of 10,000 employment suits	Stage of lawsuit	Cumulative cost for a company to defend a single lawsuit
FILING		
7,000	Settle (most settlements are for nuisance value)	\$10,000
SUMMARY JUDGMENT		
2,400	Get resolved by summary judgment and other pretrial rulings	\$100,000
START OF TRIAL		
600	Go to trial	\$175,000
END OF TRIAL		
186	Trials are won by plaintiffs	\$250,000
APPEAL		
13**	Plaintiff victories survive appeal	\$300,000

Sources: Cornell Law School, Hofstra Labor & Employment Law Journal; BW reporting

*Assumes a five-day trial

**Out of 22 trial losses typically appealed by companies

has reached the crisis stage. At that point, the best they may be able to do is suggest the kind of risk-avoidance measures that drive managers crazy—such as requiring that employee's deficiencies actually be documented in writing for an extended period before he or she is fired. This can be avoided, says Amy Rasner, a former HR manager in the fashion industry, if human resources personnel are teamed with line managers, working with them on an ongoing basis to develop and communicate specific, measurable performance objectives to employees.

In interview after interview, attorneys and HR execs say the biggest problem they confront in terminations is the failure of managers to have these kinds of conversations. In a 2002 Hewitt Associates survey of 129 major U.S. corporations, 72% said managers' ability to carry out performance management discussions and decisions effectively was the part of the personnel evaluation process most in need of improvement.

The reasons for this, of course, are varied. Some managers simply see the whole review process as a bureaucratic waste of time. It's also not easy to do. Many supervisors have been promoted into their jobs because they excelled in operations, not because they are skilled as managers. What's more, they've often spent a lot of time working alongside the very people they now oversee, so giving candid feedback to friends and former peers may be awkward. Managers in this position are "the biggest



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BECAUSE EVEN LUDICROUS LAWSUITS ARE COSTLY, THE THREAT OF THEM IS AFFECTING WORKFORCE QUALITY

chickens on earth," says Fred Kiel, an executive-development consultant at KRW International Inc. in Minneapolis.

Ironically, when it came to handling personnel issues involving Mody, GE managers appear to have done most things right, offering regular and candid performance appraisals and involving HR and legal personnel at an early stage when matters began to sour. In trial exhibits and testimony, Mody's GE supervisors described him as a talented but prickly worker. Performance reviews and other documents faulted both his people and leadership skills.

But in the trial against GE, Mody's attorney, Scott R. Lucas of Stamford, Conn., laid out the details of what he labeled a campaign of retaliation against his client. Following a July, 2002, memo in which Mody accused the company of discrimination, Lucas told jurors, Mody's boss began complaining that he was absent and tardy too often. In a court filing, Lucas called this "a contrived performance issue," and says Mody was also "falsely criticized for lack of output."

What's more, just six weeks after having given Mody a "very favorable review," his boss gave Mody a "very poor and critical evaluation," according to the filing. Mody was excluded

from various conferences and removed from "meaningful contribution" to projects. At one point, Mody's boss allegedly told him: "There are things I can ask you to do that if I ask you to do them, you would just quit." The last straw for Mody came when he returned from medical leave and was asked to do an assignment that he alleged was low-level and intentionally demeaning.

On July 18, jurors awarded Mody about \$1.1 million in back pay and compensatory damages and—in one of several aspects of the case being challenged by GE—a tidy \$10 million in punitive damages. Even for a company as big as GE, an \$11.1 million verdict is plenty of cause to justify a fear of firing. But Mark S. Dichter, head of the employment practice at Morgan Lewis & Bockius in Philadelphia, thinks that's the wrong lesson to draw from the Mody case and other similar lawsuits. "I can design HR policies that can virtually eliminate your risk of facing employment claims, but you'll have a pretty lousy workforce," says Dichter. "At the end of the day, you have to run your business." ■

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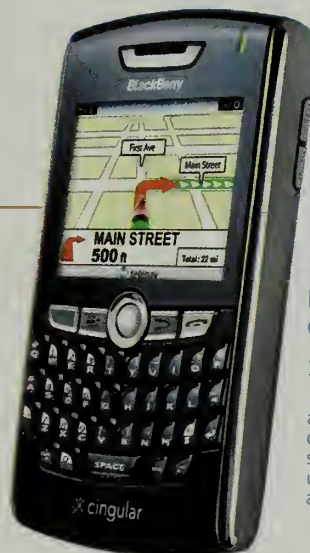
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CRUNCH TIME

The board wanted Mackay—but after he'd been schooled

idental CEO*

Kellogg needed a new boss, fast. Here's how it groomed insider David Mackay. **BY JOSEPH WEBER** Photographs by Chris Buck

WHEN THE WHITE HOUSE tapped Kellogg Chief Executive Carlos M. Gutierrez to be Commerce Secretary in the fall of 2004, few people were more surprised than the directors of the Battle Creek (Mich.) cereal maker. Gutierrez, then, had led an impressive six-year turnaround, and they expected him to lead the company for another 15 years or so. Thus the call from the Bush Administration was a shocker on a par with, say, Tony the Tiger quitting to work

for animal rights. "It fell into the emergency category," recalls director John T. Dillon. Luckily, the board had a plan—or actually two, both a short-run fix and one for the long haul. First, the directors tapped one of their own, James M. Jenness, to move in temporarily as CEO. He had served on the board for four years and worked cheek by jowl with prior CEOs for two decades as a Kellogg Co.'s adman at the Leo Burnett Co. agency. Jenness' biggest job: make the board's long-term plan work by buffing up their ultimate CEO choice, President A.D. David Mackay, now

*(well, not really)

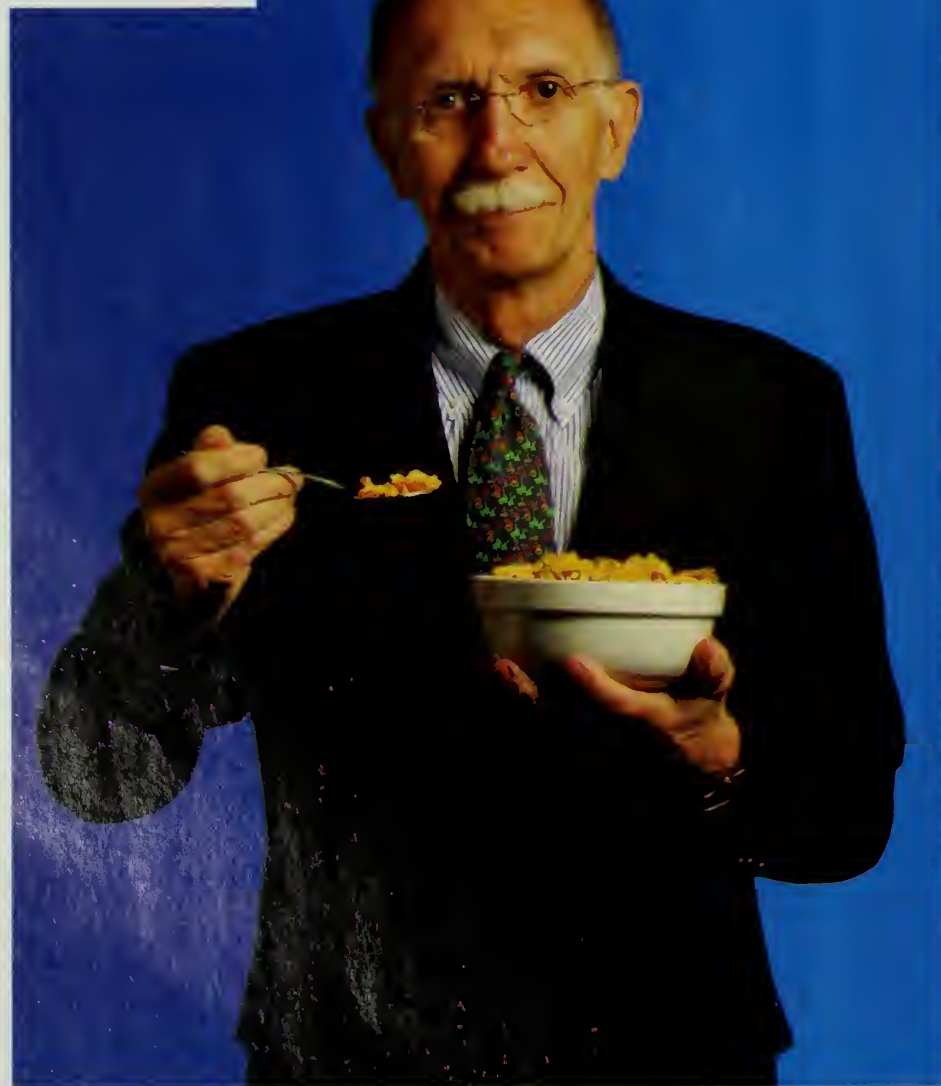


51. Jenness, 60, put Mackay through a nearly two-year crash-course in life at the top—a time that Jenness says “just gave him more ways to mature and to see some more of the game”—before Mackay took the CEO’s title on Dec. 31, 2006.

The directors swiftly rejected one option that many boards in a similar situation would have considered: tapping a high-profile outsider. Even though Mackay was not quite ready to assume the top job, the directors did not want to entrust the nearly 100-year-old company to someone who hadn’t spent his professional life hip-deep in corn flakes, Rice Krispies, and Froot Loops. Kellogg insiders “understand the company and its culture. They’re tuned in,” says director Dillon, a former International Paper Co. CEO who has served on the Kellogg board for six years. Going outside for a long-term CEO, he adds, “would confuse our shareowners, our employees, and the trade. It would send a signal that the board is not confident in its people development, and not confident in the performance and strategy.”

CEO PRO TEM

For almost two years, Jenness acted as chief while bringing Mackay up to speed



Going outside for a long-term CEO “would confuse our shareowners, our employees, and the trade,” says a Kellogg director

Fashions are changing in the boardroom: Outsiders are suddenly out. Mackay is among the 85% of CEOs appointed to S&P 500 companies last year who hailed from inside the companies: 61 out of 72 appointments, reports executive search firm Spencer Stuart. This is a sharp increase from prior year. Only 60% of a total 60 CEO appointments were internal in

2005 and 66% of 67 in 2004. While knight saviors with stellar records at other companies, once all the rage among boards that sought to shake up tired management teams are becoming increasingly passé. “People have been burned by the glamorous outsider,” says Warren G. Bennis, a professor of business at the University of Southern California. Witness the unhappy departures of Gap’s Paul Pressler, Home Depot’s Robert Nardelli, and Hewlett-Packard’s Carleton Fiorini in recent years.

WHILE AN UNFORGIVING Wall Street and relentless competition combine to give outsiders little time to learn the business, insiders can hit the ground running. They usually boast personal relationships with customers and suppliers, and already know which executives can deliver.

There’s a proven payoff to having an insider CEO: After studying shareholder returns from 1995 to 2005 for some 1,595 companies around the world, consulting firm Booz Allen Hamilton Inc. found that outside CEOs typically do better in their first few years than insiders—but that the bloom goes off the rose once the payoffs from quick fixes, such as cost-cutting, fade away. The outside CEO produced shareholder returns in the first half of their stints that were nearly four times better than those achieved by insiders, with a median annual gain of 8.6%. But in the second halves of their tenures, they fizzled, posting declines of 2.6%

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 $P = \frac{1}{2} (\rho A V) V^2 = \frac{1}{2} \rho A V^3$

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Wind Velocity [V , m/sec]

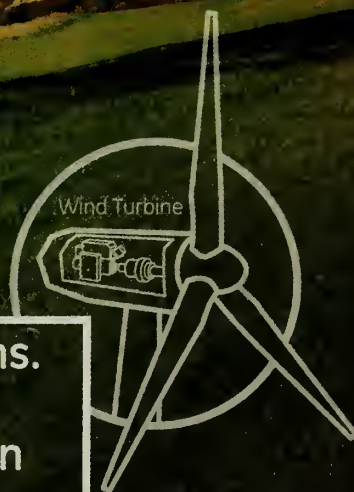
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Air Density
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Wind Velocity
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PLAYBOOK: BEST PRACTICE IDEAS

How to Grow a CEO

Developing a deep bench of talent requires identifying and cultivating high-potential managers early on.

BROADEN THEIR RANGE Rising stars should rotate through jobs, changing responsibilities every three to five years, even if the moves are lateral. Managers should be around long enough to see the results of their work—good or bad—but not so long that they'll get stale.

LET OBSERVATION TEACH Allow high-potential employees to spend time with the boss, even shadowing the boss for a week or so to see how decisions are made and executed. People learn management skills more through experience than by simply hearing about them.

ENCOURAGE OPINIONS Give rising stars room to disagree with management decisions. Throttling discussions in a top-down approach will drive out promising leaders and lead to a crop of yes-men unlikely to make good CEOs.

PROVIDE BOARD ACCESS Let up-and-comers make presentations to the board of directors: Managers gain a sense of what matters to directors, and directors get to see the talent in the pipeline. Consider having a top candidate on the company board, as well as on an outside board.

MAINTAIN A NETWORK If a top candidate leaves to go elsewhere and then returns, look on the experience as useful, not as traitorous.

in yearly returns, while insiders chugged along, racking up annual hikes of 1.1%. The imports "make bold moves but run out of moves after three or four years," says Booz Allen Senior Vice-President Paul F. Kocourek. "Either they don't know the industries or the players well enough, or don't think through the growth strategies."

AT KELLOGG, TOP LEADERS HAVE LONG COME from the inside. Before Jenness and Mackay took over, the previous five CEOs each clocked between 24 and 36 years at the cereal maker before moving to the corner office. Mackay started at Kellogg in 1985 in Australia, where he grew up, and he moved up in assignments in Ireland, Britain, and the U.S. The New Zealand-born executive, who sometimes calls colleagues "mates" and pronounces his name like "McKie," often breaks into an easy laugh and seems surprised at how far he's gone professionally. He rose from job to job every three to five years with no clear career ladder in mind, just taking every challenge in stride. But after declining a move to Asia, he felt his career at Kellogg was stymied, so left in 1992 for a rival, an Australian bakery unit of Sara Lee Corp. Wooed back in 1998, he rose to head the all-important U.S. unit of Kellogg in 2000 before being tapped as president and chief operating officer in 2003.

Kellogg directors have good reason to favor insiders. Industry veterans know that foodmaking is as much about advertising, marketing, and tracking fast-shifting consumer preferences as about factory capacities, bargaining with retailers, and the subtleties of finance. With Mackay, too, the board had someone who was deeply immersed in Gutierrez's

winning turnaround efforts; Mackay was the former CEO's right-hand man and was committed to the game plan.

Gutierrez, who started at Kellogg in 1975 and became CEO in 1999, was proof that an insider could make tough and unsettling changes—he cut staff and even shuttered an original corn flake plant—and still map a potent growth path. To drive sales, Gutierrez unveiled such novel products: Special K snack bars, bought cookie maker Keebler Co., and ramped up Kellogg's health-foods presence by snapping up Worthington Food Inc., a maker of soy and vegetarian products, and cereal maker Kashi. He pushed net earnings up 77%, \$890.6 million, from 1998 to 2000 as sales rose 42%, to \$9.6 billion. No wonder the stock soared 54%, some \$42 a share. Now, with Kellogg at \$10.9 billion a year in sales and growing nicely, the stock hovered around \$52.

When Cuban-born Gutierrez suddenly decamped to answer the adopted country's call in Washington, the directors weren't the ones surprised. Mackay never expected to get a crack at the corner office. Because he was just a year or

a half younger than Gutierrez, he figured he had topped out Kellogg. "My expectation was I'd be president of the company for many years and then probably retire as president of the company," he says.

A horse veterinarian's son who grew up in tiny Mudjee, 10 miles outside Sydney, Mackay filled most, but not all, of the bill as CEO. His biggest shortcoming was a dearth of experience in the boardroom, where he had made presentations but was scarcely intimate with Kellogg directors and lacked a boardroom insider's view of corporate life. He was immediately invited to join the Kellogg board and, to get even more experience, took a seat on the board at Fortune Brands Inc., the billion-a-year diversified marketer of Jim Beam whiskey, home hardware goods, and golf gear. The appointment, brokered by Spencer Stuart, gave him a chance to see how another company operated. And, he says, it allowed him to "get a better appreciation of the difficulty of being a director." Mackay was particularly struck by how board members operate with

Mackay lacked boardroom experience, so he was invited to join Kellogg's directors—and took a seat on an outside company's board, too

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ABRUPT EXITS

From left, Fiorina, Nardelli, and Pressler got in, but didn't last



Ousting the Outsiders

Several high-profile celebrity CEO imports have had rocky tenures

PAUL PRESSLER After four years as Gap's CEO, the 15-year Walt Disney veteran, who had little retail experience, was pushed out last January. Robert Fisher, chairman of the board and the son of Gap's founders, holds the top job.

ROBERT NARDELLI The General Electric recruit lasted six years at Home Depot before leaving in 2006. Board member Frank Blake, who joined the company in 2002 as an executive vice-president after stints at GE and in government, was tapped to be CEO.

WILLIAM PEREZ Nike founder and Chairman Philip Knight pushed out CEO Perez early last year. Perez, who had been CEO of consumer goods company S.C. Johnson, was at Nike for 14 months. Knight elevated Mark Parker, who joined Nike in 1979 and has served as president of the Nike brand unit, to CEO.

CARLETON FIORINA The former Lucent executive left the CEO perch at Hewlett-Packard in 2005 after less than six years. HP is now led by another outsider, Mark Hurd, who was recruited from NCR, where he had spent 25 years.

GEORGE M.C. FISHER In 1993, the former Motorola CEO became the first outsider to take the top post at Eastman Kodak. Fisher served until 2000, when his efforts to modernize and boost efficiency failed amid a flood of red ink.

little first-hand information, and must rely on managers whom they can trust. He was coached, too, by Jenness, who remains chairman at Kellogg. Director Dillon suggests that Mackay's internship was a big help to the CEO-apparent: "We're not all brilliant on Day One."

Jenness also slowly brought Mackay, who was chiefly an operating guy, into the spotlight for analysts and investors. He made a point of putting him front and center at the company's

annual meetings, quarterly analyst calls, and periodic major analyst meetings, so Wall Street could warm up the lanky, straight-talking manager. "It gave him time to get to know the ropes," says John M. McMillin, a former industry analyst with Prudential Equi Group, who added that functioning both chief executive and chief operating officer might have proved onerous. "It kept the heat off him."

IT ALSO HELPED THAT JENNESS and Mackay have been friends for years and, says Mackay, "get along incredibly well." They are regulars at a couple of Battle Creek golf courses and often wager on the matches. (Mackay is the stronger player, Jenness allows, but doesn't always win.) Even today, the chairman has a photo in his office of the pair horsing around and mugging for the camera. While grooming Mackay, Jenness took pains to make it clear to staffers that he and his pupil were "true partners," adding that, "when it's genuine, people can see it and smell it." Jenness also believed his joint appearances with Mackay at company meetings "would set a tone that David was somebody that I very much viewed as a potential successor."

It also helped that neither man had clawed his way into the job—and that each could bolster the other. While Mackay had a lot to learn from Jenness' ad expertise and board savvy, Mackay's operating acumen helped Jenness. Having grown close to Kellogg's working on virtually all its brands over 22 years in advertising, Jenness had left Leo Burnett as vice-chairman and COO in 1997 to run a retail consulting consultancy, and joined the Kellogg board only in mid-2000. He would pop into Battle Creek periodically for board meetings from his home in Chicago and bought a place locally only after he was tapped as CEO. When he was named to the top job, nervous investors trimmed Kellogg stock 3% as analysts such as McMillin lowered their target prices.

As for Mackay, it would have been reasonable to expect a little champion-

at the bit over a two-year stretch. But his easygoing style may have kept any impatience in check. Throughout his career, says, he worked with a two-to-three-year horizon, not knowing that the top rung was even a possibility until he was named head of Kellogg's North America unit in 2000. After earning his bachelor's degree in business at what is now Australian Charles Sturt University, he admits he had no clue about what to do. One of his most memorable early jobs was as a "re-



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BIOBOX: A.D. DAVID MACKAY

From hauling offal to heading up the No. 1 cereal maker

BORN Aug. 16, 1955, in Hamilton, New Zealand. The youngest of four children. His father was a horse veterinarian who owned race horses.

RAISED Grew up in the rural Australian town of Mudgee on the Cudgegong River. Spent part of his childhood on a farm.

EDUCATION Bachelor of Business degree in 1977 from what is now Charles Sturt University in New South Wales, Australia.

FAMILY Has two daughters with wife, Michelle. One, an adventurous idealist, wants to work aiding the local population in Tibet. Mackay's reaction: "Can you go somewhere where you can eat and not get sick?"



EARLY JOB Worked as a "raw materials movement manager"—i.e. handling the offal from slaughterhouses—for a pet foods unit of Mars Inc.

CAREER PATH Started at Kellogg in 1985. Moved through jobs in Australia, Ireland, Britain, and the U.S. Left for a Sara Lee bakery unit in 1992. Returned to Kellogg in 1998; became president in 2003. Moved into the CEO spot Dec. 31, 2006.

MAXIMS HE LIVES BY "Life takes you where it takes you"; "If you don't agree with somebody above you, you have a duty and responsibility to let them know—politely."

materials movement manager," handling offal from slaughterhouses at a pet-foods unit of Mars Inc. "Life takes you where it takes you," he muses, noting he didn't even join Kellogg until he was about 30.

KELLOGG IS TRYING TO MAKE THINGS A LOT LESS random nowadays. The deliberate, painstaking approach to succession through which Jenness led Mackay is now official policy. Kellogg expects executives to always have potential successors in mind, though ambitious executives at the various points along the management chain may not know for sure if they're in the running for their bosses' jobs. Managers must guide the career development of their protégés, trying to move them around the company every three to five years to round them out.

Mackay, who has been in his post for just a few months, is already lining up at least two potential heirs. "I've had a discussion with the board," he says. "You know, 'What happens if I get hit by a bus?'" One of Mackay's potential successors is Jeffrey W. Montie, the 45-year-old president of Kellogg North America. A marketing veteran who joined Kellogg in 1987, he's now working in the intricacies of finance. The other is Chief Financial Officer John A. Bryant, a 41-year-old Australian chartered accountant and former Deloitte & Touche executive who joined the company in 1998. He is now building his operating skills by also serving as president

of the international unit. Natural there's a built-in rivalry between Mackay's protégés—although both men, predictably, say they have too much to do to squabble. "It doesn't feel like a tension point to me," says Montie.

In addition to making sure that up-and-comers like Montie and Bryant get exposed to different parts of the business, Kellogg calls on outside experts to further the management skills of its CEO candidates. Outside coaches can also help counter any insularity a company veteran might develop. Montie is spending time with high-profile executive coach Marshall Goldsmith, who has worked with such executives as newly appointed Ford Motor CEO Alan R. Mulally, former G. Scouts of the USA head Francis Hesselbein, and General Mills Inc. Chief Financial Officer James Lawrence. (Goldsmith writes a column for *Businessweek.com*.)

Goldsmith will visit Montie frequently over an 18-month stretch, touching base with him and 24 of the people who work with him. The coach identifies shortcomings in his manager-clients—for example, an inability to listen or give recognition, or to keep a broad, strategic perspective in business decisions and helps them develop techniques to fill the gaps. He counsels Montie

an ambitious executive, to be patient and to remember to count his blessings. "My mission is to help highly successful people get better," says Goldsmith. Bryant has also worked with a coach.

Some boards are still appointing glam outsider CEOs, but generally it's only when they have failed to groom a go-to replacement, want to signal a strategic shift, or face legal problems that demand a change. Among companies that have gone outside for top talent, only to turn inside again lately, are Merck, Nike, and Fannie Mae. Jim Collins, author of leadership best seller *Good to Great*, sides with such boards. "An outsider is a hired gun," he argues. Wandering executives tend to be ambitious for themselves but not for companies they previously have had little stake in, observes Collins, while an insider may feel a deep commitment to a place that has long been his professional home.

Mackay hopes that theoretical discussions about the relative merits of insiders and outsider CEOs are a moot issue for Kellogg. He plans to lead the company for more than a decade. But if he's suddenly whisked away by, say, a phone call from the Prime Minister of Australia, the cereal giant will be ready. Kellogg's director of corporate relations, John Dillon: "We've got a deep bench." ■

BusinessWeek.com

ONLINE: Drama in the Corner Office For a slide show of high-profile insider-outsider CEO sagas, go to www.businessweek.com/extras.



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PNC May Have a Hedge Fund on Its Tail

Highfields Capital could soon be pushing the Pittsburgh bank to shake out some value

BY AARON PRESSMAN

ACTIVISTS DON'T USUALLY target companies like PNC Financial Services Group Inc. The stock is up more than 20% in 12 months. Net income nearly doubled in 2006. And the bank is at the tail end of a three-year cost-cutting plan that reduced annual expenses by \$300 million.

Yet in February the \$10 billion hedge fund Highfields Capital Management revealed that it has bought 525,000 shares of PNC in the fourth quarter. Led by Jonathon S. Jacobson, a former star at the Harvard University endowment, and Richard L. Grubman, best known as one of the first investors to question Enron's accounting, Highfields has a history of scooping up stakes in undervalued companies and pushing for change. Lately the two have opposed the management-led buyout of Clear Channel Communications Inc. So why is Highfields eyeing PNC?

Certainly, much of the low-hanging fruit that activists salivate over has been picked at PNC. Chair-

man and Chief Executive James E. Rohr upped the dividend by 15% on Apr. 5. He has also been a smart acquirer, buying a bank a year since 2004—a strategy that's helped propel PNC to the No. 50 spot on *BusinessWeek's* 2007 list of top corporate performers. Last year investment bank Merrill Lynch & Co. picked up a stake in

THE CHAIRMAN
Rohr has income up and expenses down at PNC



Untapped Potential

Here's what Highfields could want from management at PNC:

- Spin off piece of data processing division
- Use part of \$8 billion cash hoard to buy back more shares
- Recognize further gains from 34% stake in money manager BlackRock

money manager BlackRock Inc., which PNC partially owns, freeing up money for the Pittsburgh-based bank to buy Mercantile Bankshares. "You're starting to see PNC play ball with shareholders a little more than they used to," says Thomas M. Finucane, a fund manager at Loomis Sayles & Co.

Still, PNC may have some untapped potential. One move: selling part of the bank's growing data processing group PFPC Worldwide Inc., to the public markets. Based in Wilmington, Del., the unit handles the back-office work for some \$2 trillion of mutual funds and hedge funds. Similar businesses, such as State Street Corp., trade at 16 times future earnings, compared with 11 for PNC. Analysts figure investors aren't giving PNC credit for the servicing business, a disconnect that a partial spin-off would change, Rohr says a sale "is a possibility, but it's not something we're considering right now." Highfields would not comment.

Such a deal would be reminiscent of Highfields' recent successes. In 2002, it pushed then-beleaguered mutual fund manager Janus Capital Group Inc. to divest its fund servicing unit, DST Systems Inc., which Janus did the next year. Three years later, Highfields pressured management at Mellon Financial Corp. to sell a similar business that the investor thought didn't complement the bank's money-management group. Mellon publicly rejected Highfields' demands but sold the entire company to back-office servicing giant Bank of New York Co. less than a year later.

Others contend Highfields may want PNC, which had \$8 billion in cash in 2006 to pick up the pace of its stock buyback. PNC retired 5 million shares last year and has the board's approval to take an additional 14.5 million off the market. Rohr already plans to speed up the process.

Meanwhile, PNC still owns 34% of BlackRock. It's worth about \$7 billion, but PNC only carries BlackRock on its books for half that. When PNC can increase the value of BlackRock on its balance sheet, it would free up capital elsewhere on the books—money it could use for more acquisitions or buybacks.

Of course, there's always the possibility Highfields will take a more passive approach. That's what Rohr thinks. So far, he says, Highfields hasn't come calling. "There's this concept that they are nature activists in all their investment but they manage so much money that they can't be." ■





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Can Wachovia Rewrite The Rules of Debt?

If the bank fends off a lawsuit from eight hedge funds, it could roil the loan market

BY MATTHEW GOLDSTEIN

TAKEN BY ITSELF, THE ALLEGED fraud at Le-Nature's Inc., the now bankrupt distributor of flavored waters, fruit drinks, and teas, has the makings of a nice yarn. But while founder and former Chief Executive Gregory J. Podlucky may have maintained two sets of financial records, inflated sales by as much as \$240 million in 2005, and bilked millions from a company brokerage account, the possible hanky-panky is only part of the story.

Now eight hedge funds, which bought \$160 million of its bank debt after Le-Nature's filed for bankruptcy in November, think the company's main lender, Wachovia Corp., should be on the hook as well. Wachovia, the nation's fourth-largest bank, arranged a \$150 million bond offering for Le-Nature's in 2003 and a \$268 million loan deal in September, just weeks before the alleged scheme came to light. Some investors contend Wachovia overlooked red flags during its due diligence on the deal, notably a lawsuit filed in June claiming Podlucky failed to provide minority shareholders

of the privately held company with certain financial information.

Wachovia says it was unaware Podlucky may have cooked the books and asserts that it, too, was a victim, losing \$17 million after the company went belly up. Wachovia is trying to block the group—which includes hedge funds Harbinger Capital Partners, Latigo Partners, and Taconic Capital Management—from suing, contending that it snapped up the distressed debt with the intention of jumping on the litigation bandwagon. The Charlotte (N.C.) bank got a restraining order against the investors on Mar. 14 that banned them from filing a case outside its home state.

The legal beef between Wachovia and the hedge funds raises a lot of questions for investors in this arena. The \$1.7 trillion market in syndicated debt, big commercial loans financed by multiple lenders, depends heavily on the ability of hedge funds and others to buy and sell such

issues easily. Troubled stakes are piece, some 17% of the \$239 billion secondary loan market. If that debt sours when a company goes bankrupt, investors can usually recoup of their losses by going through channels.

CHANGE OF VENUE

BUT IF THE COURTS ultimately prohibit hedge funds and the like from suing which would take away their last at recouping assets in bankruptcy proceedings—the market could be in trouble. That's why the Loan Syndicating & Trading Assn., an industry group which Wachovia is a member, is teaming up with the hedge funds in this dispute. Elliot Ganz, the LSTA's general counsel in filings with the court, said the restraining order “would seriously threaten liquidity and efficiency of the market.”

The outcome of the current situation depends largely on where the lawsuit is filed and eventually heard. The preventive strike by Wachovia is more than a play for home court advantage; North Carolina state law usually bars investors from buying claims simply to sue for fraud and negligence. If Wachovia proves the funds bought Le-Nature's debt solely for its legal rights and the case stays in the Tar Heel State, the funds could be stuck with a worthless investment. A Wachovia spokeswoman says the bank isn't trying to undermine the legitimate trading in debt” but is open to “trafficking in tort claims.”

Given the potential ramifications, hedge funds are pushing aggressively to overturn the ruling. Filing the suit in New York, for example, would be in the funds' favor. There's a long established precedent there in both state and federal courts, where many commercial lending disputes are heard.

investors who buy debt in the secondary market have the right to sue the bank that arranged the loan. Says Barry E. Carter, a professor at New York University School of Law, “This [case] could be a monkey wrench in claims trading.”

So far the funds' lawyers declined comment, have been unsuccessful in their attempts to move the case to another venue. For now that means the funds are stuck playing Wachovia's backyard.

THE STAT

\$160 million

The amount of Le-Nature's bank loans bought at a major discount by eight hedge funds

Data: Court filings

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Under the Weather At J&J

Three big products have seen setbacks, with little in sight to replace them

BY ARLENE WEINTRAUB

THERE ARE ADVANTAGES to being a health-care juggernaut like Johnson & Johnson. With more than 200 different operating companies, weakness in one unit rarely causes more than a tremor on the bottom line. But it's a different story when three big products run into trouble simultaneously. That's the worry on Wall Street as J&J gets ready to announce its first-quarter earnings on Apr. 17. Fears that J&J could temper its profit estimates for the remainder of this year have pushed the company's shares down 7% since its last earnings announcement—the stock's biggest drop in over 12 months.

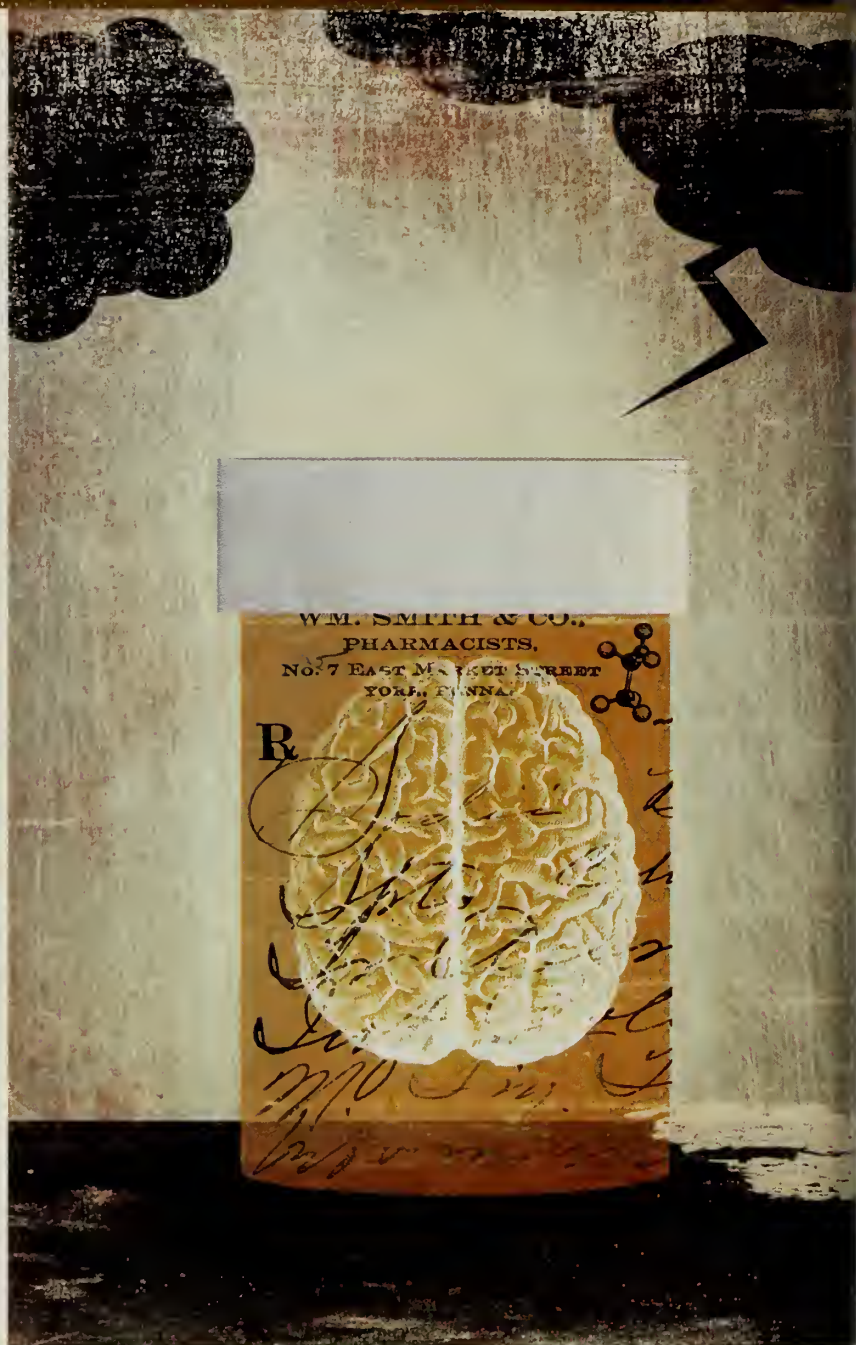
The jitters center around three of J&J's most profitable products. Safety concerns have dampened demand for coronary stents and the anemia drug Procrit. Meanwhile, J&J's new schizophrenia drug—one it's counting on to replace lost revenues from an older drug that's going

off-patent next year—isn't catching on as quickly as some Wall Street analysts had hoped.

Together, the three product franchises made up 19% of J&J's \$53.3 billion in 2006 sales, but they contributed almost 40% of the company's \$13.7 billion in operating profit, estimates Credit Suisse First Boston analyst Catherine J. Arnold. On Mar. 29, Arnold issued a report predicting J&J might backpedal on its earlier estimates that it would earn a net profit of at least \$11.4 billion in 2007, up from \$11 billion last year. J&J declined to comment, citing a pre-earnings quiet period.

Of J&J's three challenges, the schizophrenia shortfall is causing the most hand-wringing. In January, J&J launched a new anti-psychosis drug called Invega, which is derived from its older drug Risperdal. In 2006, Risperdal was J&J's top-selling product, with \$4.2 billion in sales, and J&J has positioned Invega as a potential improvement. But analysts such as Michael Krensavage of Raymond, James suspect J&J is having trouble making a convincing marketing pitch. "I'm not sure how much better a drug it is than Risperdal," he says.

Some psychiatrists are wondering the same thing. Because Invega is a controlled-release drug, patients may be able to take it less frequently than they take Risperdal, which could be a benefit in a segment where patients often fail

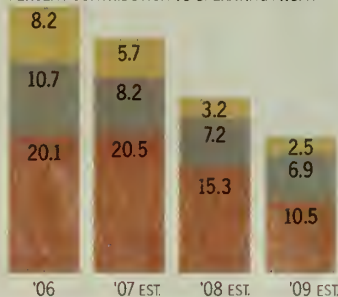


TRIPLE WHAMMY

Three of J&J's key profit drivers are beginning to fade

■ STENTS
■ ANEMIA
■ SCHIZOPHRENIA

PERCENT CONTRIBUTION TO OPERATING PROFIT



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stick to their medication schedules. But when patients are psychologically unstable, changing their meds for the sake of convenience isn't necessarily a good strategy. "When we don't see a clear advantage of a new drug, we're less likely to want to rock the boat," says Dr. Joseph Friedman, associate professor of psychiatry at the Mount Sinai School of Medicine in New York.

The FDA added a warning to anemia drug Procrit

Insurance companies might also be balking at Invega. On Mar. 20, J&J Vice-Chairman Christine A. Poon told attendees of the Lehman Brothers Global Healthcare Conference that J&J still had some work to do to get Invega prime placement in Medicare drug plans run by private insurance companies. On the drug "formularies" that dictate which products patients have access to and what co-pays they'll have to shell out, "we're not completely satisfied" with Invega's status, Poon said. "We believe there are still too many restrictions." While she didn't elaborate, such restrictions often include requiring doctors to get permission from a patient's insurance company before prescribing a new drug. The hassle could well add to doctors' hesitation in embracing J&J's new treatment.

BAD VIBES

INVEGA'S SLOW TAKEOFF would be a mere blip on J&J's balance sheet if not for weaknesses in two other big products. The anemia drug Procrit, which has been steadily losing market share to a competing drug from Amgen Inc., suffered another blow on Mar. 9. The Food & Drug Administration added a dreaded "black box" warning to the labels of all the drugs in the class (box). On May 10, an FDA advisory committee will meet to discuss new data on the use of anemia drugs in cancer patients. "We look at this whole issue as a process of reevaluating this class of agents," said Dr. Karen Weiss, deputy director of the FDA's Office of Oncology Drug Products, in February. Even if the agency doesn't issue further warnings, the attention will only intensify the bad vibes surrounding Procrit. Credit Suisse analyst Arnold estimates sales of the drug, which hit \$3.2 billion in 2006, will fall nearly 9% a year through 2011.

Then there are drug-coated stents,

the tiny tubes used to prop open clogged arteries. Over the past few months, several studies have raised concerns that the stents may cause dangerous blood clots in some patients. Even though the data are far from conclusive, the damage has already been done. In February drug-coated stents were used in 70% of artery-opening procedures, down from 90% a year ago, according to Toronto's Millennium Research Group. In the fourth quarter, sales of J&J's cypher stent fell 15% year-over-year, to \$580 million. During the Apr. 17 earnings call, investors will be eager for hints about the stent outlook for this year.

J&J hopes its aging franchises will be

bolstered by new products coming from its labs, where scientists are working on treatments for diseases ranging from HIV to psoriasis. "We don't commit to doubling growth every single year, but we do have this goal of delivering that kind of growth over long periods of time," Poon said during the Lehman conference. Still, the company continues to get unpleasant reminders of just how difficult it can be to translate scientific discovery into blockbuster drugs. On Apr. 4, J&J partner IcaGen Inc. halted a clinical trial of a treatment for sickle-cell anemia that the two companies planned to market together. The data suggested the drug wouldn't pass muster with the FDA. ■

THE FDA

Vioxx Casts a Long, Long Shadow

Added to the drug industry's problems an increasingly harsh regulatory environment. More than two years after Merck & Co. pulled its Vioxx painkiller from shelves over heart attack and stroke risks, the Food & Drug Administration is still skittish about the safety of drugs currently on the market and those coming up for review. In February regulators asked Genentech Inc. to relabel its allergy-related asthma drug Xolair, which had \$425 million in sales last year, to take stock of serious allergic reactions the drug can cause in rare cases.

A month later, on Mar. 9, the FDA imposed a strict "black box" warning on blood-boosters, one of biotech's oldest, most widely prescribed classes of drugs. These medicines, which include Amgen Inc.'s Eprex and Aranesp and Johnson & Johnson's Procrit, were approved to treat anemia in patients with cancer and chronic kidney disease. But they appear to cause cardiovascular problems when given in high doses for various conditions.

Also on the FDA's safety checklist is a raft of insomnia treatments such as Sepracor Inc.'s Lunesta and Sanofi-Aventis' Ambien, which pose risks ranging from allergic reactions to "sleep driving," regulators say. In the wake of these warnings, Merck halted clinical trials of its own insomnia drug, gaboxadol, which produced hallucinations



NEW WORRIES about existing drugs

in some test subjects.

Now, Wall Street is watching to see how the FDA deals with Merck's latest arthritis drug, Arcoxia, which works by the same mechanism as Vioxx. The company was scheduled to present data to the FDA's Arthritis Advisory Committee on Apr. 12.

As warnings about existing drugs have multiplied in recent months, patients' groups and politicians have banded together to call for regulatory reform. On Mar. 14, the Senate held hearings on a bill drawn up by Senators Michael Enzi (R-Wyo.) and Edward M. Kennedy (D-Mass.) that would, among other things, increase the FDA's ability to monitor drugs after they are approved.

-By Alex Halperin



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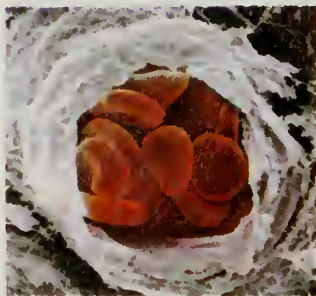
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MEDICINE

A TEST FOR METASTATIC CANCERS

CANCER PATIENTS often don't realize the disease has spread until a secondary tumor grows big enough to show up on an X-ray or CT scan. Battelle Medical Device Solutions now has a patented test that could detect a recurrence much sooner using only a routine blood sample.

Battelle says its approach, developed by Thomas Haubert of its Columbus (Ohio) research lab and Dr. Stephen Wardlaw of Yale University School of Medicine, can find a single cancerous cell in as little as 10-cc's of blood. The system doses the sample with a fluorescent tag that sticks to abnormal cells, which are then separated out in a centrifuge for identification.

—Michael Arndt

AVIATION

BOEING ADDS SOME GREEN TO THE WILD BLUE YONDER

BOEING WILL soon push the green envelope in the skies over Spain, testing the first manned plane powered only by a fuel cell and batteries. The single-engine prop plane, with a wing span of 53.5 feet, will cruise at a leisurely 62 mph drawing only on its fuel cell. The lightweight lithium-ion batteries will kick in during the takeoff and climb.

Will commercial airplane passengers ever be whisked across continents by fuel cells and a bed of batteries? Not likely, observes Francisco Escarti, managing director of Boeing's R&D lab in Madrid. But experiments like this will help "pave the way for potentially using this technology in small manned and unmanned air vehicles," he says.

Fuel cells convert hydrogen and oxygen to electricity without combustion, and water is the only by-product. Energy is consumed—somewhere—to produce the hydrogen, of course; even so, if planes like these ever become practical, they'll be far cleaner than any existing propeller or jet planes.

—Stanley Holmes



WAR WOUNDS

VIRTUAL HELP FOR REAL PAIN

IN ONLINE communities such as Second Life, people create digital doppelgangers of themselves—avatars who shop, go to conferences, and even procreate. Researchers at the University of Manchester in Britain say the same technology is helping amputees suffering from phantom limb syndrome, a common complaint among soldiers returning from Iraq.

The patient learns to conquer the pain that persists in the location of a lost limb by placing a motion-capture glove or sock on his healthy hand or foot, then manipulating virtual versions of both the existing and missing limbs on a computer screen. It's not clear why this relieves pain, but the technique seems to work, says researcher Steve Pettifor.

At the Madigan Army Medical Center in Tacoma, Wash., virtual reality will help treat the effects of post-traumatic stress disorder, including terrifying flashbacks to the battlefield. The troubled vets don virtual-reality helmets and roam through different battle scenarios, navigating via joysticks. The effect is therapeutic, doctors say, because the simulation reexposes soldiers to the sources of their terror—only this time, in small doses, so they can gradually become desensitized to the memories.

—Aili McConn

INNOVATIONS

Of bipolar brains, health-care bucks, and bioplastics

» Doctors may have gained a keen new insight into why lithium is an effective treatment for patients with bipolar disorder: It increases the amount of gray matter in several key regions of the brain, say neuroscientists at the University of California, Los Angeles. The scientists observed the increases using high-resolution MRI and a technique called cortical pattern-matching. There was no evidence the changes persisted when lithium treatment was halted.

» Health experts have long known that complications of Type 2 diabetes, such as heart failure, heart attack, and stroke, take a financial as well as a human toll, but the real cost has been difficult to quantify. Now there's a number: A new report from the American Association of Clinical Endocrinologists estimates the U.S. spent \$22.9 billion treating such complications in 2006. Per capita, that's about three times the cost of treating non-diabetic Americans.

» Eco-friendly ideas don't always require trade-offs in cost or performance. Scientists at NEC in Japan have developed a plant-based plastic reinforced by carbon fiber that diffuses heat more effectively than steel or other materials. If used as housing on devices packed with microcomponents—laptops, cell phones, and the like—the bioplastic could conduct heat away from delicate circuits better than standard plastics or metals, and thus prolong the life of a product.



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The Marshal Of MySpace

How Hemanshu Nigam is trying to keep the site's 'friends' safe from predators and bullies

BY PAULA LEHMAN

JUST LIKE THE REAL world, MySpace.com needs an enforcer. The man trying to bring order to the planet's biggest social networking site is a former federal prosecutor named Hemanshu "Hemu"

Nigam. He was hired a year ago to keep MySpace's largely youthful denizens safe from predatory grown-ups—and from one another. For MySpace owner, News Corp., patrolling the virtual streets is not simply a

matter of keeping kids safe, it's also crucial if the company is to attract sufficient advertising to help boost profits. "I am humbled by the sense of responsibility," says Nigam, who spent three and a half years at the Justice Dept. helping put child molesters behind bars. "As a company, we have to forge the way for an entire industry."

Nigam's main constituency—beyond advertisers—is parents, who have fretted about two things: pedophiles who use the site to prey on their children and kids who use the Web to bully class-



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“I am humbled by the sense of responsibility. As a company, we have to forge the way for an entire industry.”

—Hemanshu Nigam,
Chief Security Officer,
MySpace

mates. Nigam, 42, is drawing on his ties to law enforcement and his four years running Microsoft Corp.'s security technology unit to make the site safer. So far the efforts have won him accolades from erstwhile MySpace critics. One is Anne Collier, co-author of *MySpace Unraveled*, a parent's guide to social networking. Collier says MySpace is “showing a lot of corporate responsibility.”

When Nigam arrived, MySpace had a real problem on its hands. Pedophiles pretending they were teenagers had been using the site to lure kids to offline rendezvous. A barrage of criticism from parents and prosecutors had politicians in Washington muttering darkly about imposing restrictions on MySpace. Clearly, getting rid of the perverts was a priority.

Today automatic privacy settings on MySpace block everyone but acknowledged friends from visiting the profiles of underage users. Interaction between minors and those over 18 is blocked unless the adults can provide the e-mail address and the full name of the youngster to whom they are sending a message. Complicated algorithms are in place to mine thousands of search terms that are commonly used by online pedophiles. And

each week, says MySpace, Nigam and his team, which includes former prosecutors and police officers, delete 8,000 profiles of people who misrepresent their ages.

Nigam understood early on that he needed to reach out to his former colleagues in law enforcement. One of his shrewdest moves: using MySpace's technical expertise and reach to build a sex offender database and donate it to the National Center for Missing & Exploited Children. Launched with assistance from Sentinel Tech Holding Corp., a leader in online identity-verification technology, the database features e-mail addresses and physical descriptions for more than 500,000 registered sex offenders. Now, when police officers are looking for a sex offender, they can tap into the new database.

Nigam is using the power of MySpace to help authorities in other ways, too. His team recently tracked down a runaway teen who continued to log into her MySpace account. In another instance, a teenager blogged that she was going to kill herself. A suicide hotline called MySpace, which found her computer's location and called police. “Hemu is an innovator,” says Detective Richard Wisstocki of the Naperville (Ill.) Police Dept.,

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SmartMoney selected funds from seven investment categories based on performance (before and after taxes), low turnover, and expenses as of 11/30/06. The Global Stock, Growth Stock, and Value Funds were selected among several funds in the global, large-cap growth, and large-cap value categories, respectively.

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INVEST WITH CONFIDENCE

Average annual total return figures include changes in principal value, reinvested dividends, and capital gain distributions. *The funds' expense ratios are as of their fiscal years ended December 31, 2005 (except for Global Stock Fund, which is as of its fiscal year ended October 31, 2006). T. Rowe Price Investment Services, Inc., Distributor. SM35075146

who has worked with MySpace to arrest pedophiles. "And he's proven we can work together."

In some ways cyberbullies present a tougher challenge. While kids have been known to out gay classmates, post clips of schoolyard beatings, and even threaten teachers, their actions usually don't break the law. Nearly half of the teens polled by the National Crime Prevention Council (NCPC) in February, said the bullying happens because the perps believe they won't get in trouble. But the impact on the victims is all too real. Last year, classmates of Olivia Gardner, a middle school student from Novato, Calif., who has epilepsy, opened an "Olivia Haters" club page on MySpace. Olivia's mother, Kathleen, is now home-schooling her.

ONLINE ETIQUETTE CLASSES

NIGAM'S MAIN WEAPON in the battle with the bullies is education. He has given kids, parents, teachers, and police guidelines to curb the scourge. And MySpace recently gave free space to a powerful ad from the NCPC and the Advertising Council. In it, a girl addresses her classmates. "Today I'm going to talk about Patty," she begins. And then goes on to recite a litany of insults, ending with: "Everyone hates her, even the teachers, who are supposed to like everyone. Get a life, Patty." Then comes the tagline: "If you wouldn't say it in person, why say it online?"

Of course, education only goes so far. Nigam deletes profiles of known bullies and refers some to the police. MySpace also allows users to block a bully's profile, review e-mails before they get posted on their own profiles, or simply hit the "report abuse" button available on every MySpace page. Kathleen Gardner is skeptical of these efforts because the online bullying resurfaced last month after her daughter tried switching schools. "Now that it's happened again," she says, "MySpace is not even allowed in my house."

Nigam and Gardner agree on at least one thing: the need for legislation. Nigam is pushing states to follow Virginia's lead by making classes on online etiquette mandatory in schools. He is also lobbying state and federal legislators to require convicted sex offenders to register their e-mail addresses. New legislation would also mete out 20-year terms for people who lie about their age on the Web to solicit sex from a minor. Nigam and his team have done much in one year, but the war is far from won. ■

—With Tom Lowry

Go-Go-Going To Pieces in China

Frazzled managers are displaying all the classic signs of Western-style stress

BY MICHELLE CONLIN

AS CHINA GUNS IT from planned to market economy, the professional class is starting to display the same symptoms of modern angst that appear daily in the corridors of America's office towers. Burnout. Eating disorders. Depression. Substance abuse. "For China, it's as if the world has completely flipped on its axis," says Russ Hagen, CEO of employee assistance firm Chestnut Global Partners.

The radical structural changes in the Chinese economy have left many workers suspended between the old world and the new. The pressure to compete for one's precarious place at work is straining relations with colleagues. Performance reviews once based on effort are now about results. Family used to rule. Now making money does. "There's this sense of frenzy," says Richard Xu, who runs a human resources association in Beijing. "People don't want to stop, because they could lose out on an opportunity."

If this were North America or Europe, a visit to the family shrink or company counselor might be in order. But this is China, where psychological therapy has long been anathema. Admitting you need help is just not done in a face-saving culture. That may explain in part the newfound spirituality among professionals in a land that still officially frowns on religion. Buddhism in particular is experiencing a revival among stressed-out urbanites seeking respite from the pressures of the office. So far, Beijing tolerates the trend.

The distrust of all things psychological hasn't deterred Western firms from

trying to convince Chinese that a lit therapy can go a long way. For several years multinationals have offered counseling to their expatriate managers. Increasingly, they're extending such benefits to local hires. The services range from helping employees find child care to relationship counseling to dealing with credit-card debt.

Now, U.S. employee-assistance firms are starting to sign up local clients. Chestnut Global Partners, which has 11 new offices in Beijing, recently won a contract with Minsheng Bank, one of China's largest publicly traded banks. Chestnut quickly found that what works in the U.S. won't fly in China. Rather than behavioral counseling, it



firm sells a "personal well-being service." Instead of going on about conflict management, Chestnut stresses "workplace harmony." And since Chinese workers are loath to meet one-on-one, the firm makes great use of online group sessions. So far, employees have confronted the same issues that Americans struggle with: bad bosses, sagging job performance, disappointed spouses and kids. Chestnut reports that twice as many of its Chinese clients' employees take advantage of its services than Americans. Progress, as always, comes with a price. ■

—With Dexter Roberts in Beijing

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Climate Wars: Episode Two

With the skeptics almost silenced, businesses are fighting over how to cut carbon emissions

BY JOHN CAREY

REMEMBER THE ARGUMENTS for not taking action against global warming? Just a few years ago the claim was: "There's no evidence that the climate is changing." Then it became: "Well, maybe it is, but humans aren't to blame." That morphed into: "Warmer could be better, and we

can easily adapt." And all along, we heard that cutting emissions would cripple the economy—and wouldn't make much difference because China and India weren't on board.

Forget all that. For most companies, the science debate is ancient history. The current argument, which could turn ugly, is about how the government should act to curb carbon emissions. "We've reached a tipping point on this issue," says Jeff

Sterba, CEO of Southwestern utility PNM Resources. Where automakers once fought the Kyoto Protocol, they now backing mandatory greenhouse gas limits that could go beyond Kyoto. The Edison Electric Institute, a utility industry group, has come around despite its members' coal-fired plants. "Looking back, I wouldn't have believed it was possible EEI would evolve to where we are today on this issue," says James Rogers, CEO of Duke Energy Corp. On Apr. 11, ConocoPhillips became the first major U.S. oil company to call for carbon caps. Even Exxon Mobil Corp., which has spent millions to raise doubts about climate change, now claims to have been misunderstood. "Our approach to this has evolved," says Kenneth P. Cohen, vice-president for public affairs.

There are still holdouts, not the least George W. Bush. His mantra is that China and India must sign on if the U.S. is to impose curbs. Peabody Energy has hired ex-House Majority Leader Richard A. Gephardt to lobby against carbon curbs. And while many companies are waving green flags, environmentalists worry that some are more interested in protecting themselves than in saving the planet, since those not willing to negotiate could face higher costs. As Charles Territo of the Alliance of Automobile Manufacturers says: "If you're not at the table, you're on the menu."

Whatever the motivations, a profound shift has occurred on global warming. With Congress beginning work on a slew of bills, "the entire discussion has progressed from 'nothing is going to happen' to wrestling over the details," says Philip E. Clapp, president of National Environmental Trust. "The jockeying has begun."

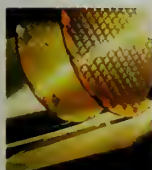
ExxonMobil's Cohen, for instance, is talking up large reductions in carbon dioxide that could come from better auto-fuel economy. Wait a minute: the Big Three carmakers retort: Since cars generate just 20% of the nation's emissions, it's not fair for us to bear the brunt. Meanwhile, utilities are wrangling over how to dole out the rights to emit under a national cap on emissions. "The groups are trying to get the best deal possible," says Brent W. Dorsey, director of corporate environmental programs at New Orleans utility Entergy Corp.

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of the bills in Congress, is a system called cap and trade. The idea is that individual industries and companies must reduce emissions to a certain level. If they are unable to do so, they can buy rights or allowances from others who emit less than their set limit. The market then finds the least costly ways to cut emissions most quickly.

There are a host of thorny issues. If a power plant already produces a million tons of CO₂ a year, does the utility have to buy allowances, or is it initially granted free credits for most of those million tons? Or if a utility has already cut emissions in anticipation of regulations, does it get credit for those reductions? Utilities such as Entergy, which have nukes and renewable energy sources, are complaining that their coal-heavy counterparts are angling for additional allowances and so will gain a competitive advantage.

Heavier coal burners, such as Duke and American Electric Power Corp., in turn say treating utilities equally would give the lower emitters a windfall. And the timing of mandatory reductions is crucial. "If we have to reduce carbon before we have the new technology to do it, we will put ourselves in a world of hurt," says Sterba.

Even as this fight over allocations heats up, many groups that once challenged the science are taking aim at the whole idea of cap and trade. Better to pass a tax on carbon, they say, which would be a more efficient way of encouraging business and consumers to make less carbon-intensive energy choices.

That's a favorite idea of Exxon, too. But cynics note that taxes have always been political suicide and therefore are unlikely to be enacted. It would also take a lot of trial and error to come up with a tax that limits emissions to a desired target.

Why the dramatic shift from resisting the science to wrestling over policy? One reason: The long contrarian campaign has lost credibility. The main goal, stated in company and trade-association documents, was to sow as much doubt as possible. As a 1998 American Petroleum Institute memo says: "Victory will be achieved when...recognition of uncertainties becomes part of the 'conventional wisdom.'"

The contrarians got years of mileage out of the early finding that satellite and balloon data didn't show

atmospheric warming. Mainstream scientists discounted the data since such measurements are indirect, tricky, and prone to errors. Skeptics, however, had no such reservations. The data are "screaming that the...climate models are wrong," wrote Cato Institute senior fellow Patrick J. Michaels and two others in a 2004 *Washington Times* op-ed piece. "The science is settled. The 'skeptics,' the strange name applied to those whose work shows the planet isn't coming to an end, have won."

Not quite. With better analysis of the satellite measurements, the data changed. Even Michaels says: "Clearly, there has been warming." As for his earlier claim, he says, "who was going to anticipate that the satellite data were going to be revised?" Growing evidence knocked out a half-dozen other objections to the science.

In addition, contrarians have taken a hit from a savvier media. Instead of just quoting a scientist on both sides of the debate, journalists increasingly have assessed the weight of the evidence and explained who was behind the opposing views. "Once a story says 'funded by ExxonMobil,' it loses credibility," says Greenpeace Research Director Kert Davies. The oil giant has now closed its cash spigot to some groups challenging global warming. "The funding was unfortunately becoming a distraction," says ExxonMobil's Cohen.

The doubters haven't disappeared completely. Michaels now says: "hardly news that human beings had a hand in planetary warming," he still argues that warming could be beneficial. "Who's to say we have the climate now?"

A STATE PATCHWORK

COMPANIES FIND it's no longer worth arguing this point. They're coming to the bargaining table for many reasons beyond the science. On Apr. 2 the U.S. Supreme Court ruled that the Environmental Protection Agency can regulate CO₂ as a pollutant. That could bring legal challenges and EPA-imposed mandatory curbs. "The fear that the new Administration's EPA would have its hand on the lever is a great motivator," says Natural Resources Defense Council attorney David D. Doniger. Plus, a growing patchwork of state carbon-emission limits has prompted industries to push for a preemptive national law. And energy executives face decisions, such as what kind of power plants to build in the next 40 years, they want regulatory certainty.

Despite the tough road ahead, proponents of action inside companies are thrilled that the policy fight is finally begun. "We are long past debating the science," said Entergy CEO J. Way Leonard in a recent speech. Waiting for stronger evidence is "the equivalent of bleeding out of every orifice of your body and hearing your doctor say: 'Before you rush to judgment, let's wait until all the facts are in'—meaning your autopsy."

—With Adam Aston in New York

The Supreme Court's ruling that the EPA can regulate CO₂ "is a great motivator"

A New Climate Controversy

As industry grapples with how best to respond to climate change, a battle has broken out over how to implement a cap-and-trade system—or whether to impose a tax on carbon emissions instead

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Traditional opposition to taxes could doom the proposal. If carbon taxes did make it through Congress, how would the proceeds be used?

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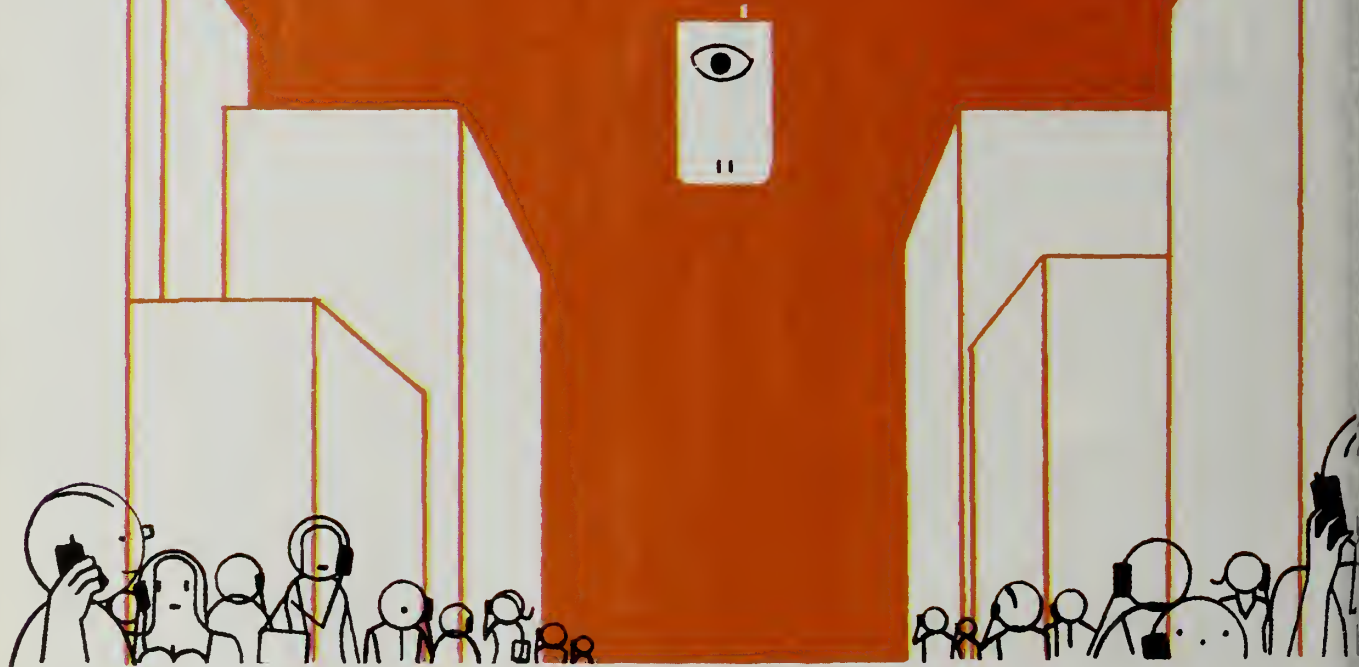
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The Sell-Phone Revolution

Stay tuned for a message from your cell phone, which seems to know an awful lot about you

BY CATHERINE HOLAHAN

TERI MILLER HAS FOUR kids—three boys and a girl, ages 5 through 13. She is 34, works as a hairdresser in Sarasota, Fla., and recently vacationed in Las Vegas. Most important, she doesn't mind strangers knowing all this—even if they use it to sell her things. Simply by sending a text message to a number she saw on a Las Vegas billboard in February, Miller gave Adidas and a marketing outfit, MOVO, all the information they needed to hawk basketball shoes to her over the phone.

They knew Miller was in Vegas, since she responded to the billboard offering information about National Basketball Assn. All-Star game events nearby. Her

phone number gave away her hometown, indicating an allegiance to the East Coast All-Star team. The payoff came when Adidas sent Miller a text message about the sale of 200 pairs of limited-edition All-Star basketball shoes. Tipped off, Miller lined up outside an Adidas store in Vegas with hundreds of others. "We got there really early with our big ol' cup of coffee," says Miller, "and of course the line was out the door." She bought two pair for her eldest boys.

Advertising is about to get very personal. Marketers are taking tools that they already use to track your Internet surfing and are preparing to combine that information with cell-phone customer data that include not just the area where you live but also the street you're standing on. The aim is to target the

exact person who is most likely to buy a product at the precise moment they most likely to buy it. It's the ad industry dream come true: a perfect personalized pitch. For privacy advocates, though, the combination of behavioral and geographic targeting is an Orwellian nightmare.

HUMBLE BEGINNINGS

CAMPAIGNS THAT COMBINE Web data with location information to target ads from nearby businesses to individuals are just a couple of years away, mobile marketers say. Already, mobile services use area codes, Zip Codes, and even Global Positioning System (GPS) data to return results for nearby businesses in response to a search for, say, coffee shops. The next step is to serve an ad for a steaming cup of java on a mobile Web page just as the cell-phone Web surfer is passing a Starbucks. Within five years, online ad networks such as TACODA and Specific Media Inc. plan to apply behavioral techniques—using surfing data—to target ads to broadband-enabled digital television. It's not hard to imagine the day when multiple TV channels tuned to the same channel in the same household will serve up different ads. "There is no question behavioral targeting will be a major component of television," says Dave Morgan, TACODA founder and chairman.

Early efforts at such hypertargeting are modest for a good reason: Phone



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members of the household, most mobile phones have one user. Any mobile data that are collected help build a profile of a unique individual. Mobile carriers also can leverage data from service contracts and billing logs.

What's more, cellular networks are able to locate callers to within 50 to 300 meters by triangulating signals, something the FCC requires them to do for 911 calls. Providing the carrier has consumer permission, that could be matched up with, say, a hip fashion boutique that has purchased an ad for women ages 15 to 25 who have surfed the Style.com Web site in the past month.

cell
phones
sit
in a
wizard
oam?

All told, marketers will spend just \$3 billion worldwide on mobile ads this year, according to an Apr. 10 report by ABI Research, an industry research group. But that's expected to grow to \$19 billion by 2011 as more users surf the Web via

dataset. Many marketers eagerly await the day when carriers release location information to them.

Many citizens, of course, are hoping the vault remains shut. Marc Rotenberg, executive director of the Electronic Privacy Information Center, says consumers expect privacy with their cell phone and won't react well to location-based marketing. "Any advertising that causes someone to flip open their cell phone and see an ad won't be a winning moment," says Rotenberg. Marketers such as Medio's Tawakol are quick to point out that most ads will appear on mobile Web pages and not as text messages. He also notes that marketers don't have, or even want, customers' names, because brands want to reach highly selective groups of consumers, not just the masses.

The bigger concern for many mobile users may be that advertisers will simply grow their phone number. The industry is tentatively developing guidelines that protect users from being barraged with messages—restricting, say, how often an advertiser may contact the same consumer in a month. But that cat may be out of the bag: Mobile-phone users who received unwanted messages already have filed lawsuits against marketers.

If you're feeling spammed, of course, the whole appeal of targeting is turned on its head. Now you're angry—and it's personal. ■

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ON TODAY'S

Agenda:

TOMORROW

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How Accenture One-Upped Bangalore

It leads the pack in tech services, melding offshoring and classic consulting

BY STEVE HAMM

WHEN THE INDIAN outsourcing upstarts came on strong five years ago, it looked as if some giants of the \$600 billion tech services industry would fall like top-heavy palm trees in a Category 4 hurricane. The Indians' combination of high quality and super-low cost flattened the stock prices and revenues of companies such as EDS, BearingPoint, and Capgemini. Even mighty IBM, the No. 1 tech services player, has struggled to rebound.

One Western company has come through stronger than ever, though—and it did so by motoring straight into the eye of the storm. Accenture Ltd. has responded so well to the disruptions caused by Indian companies such as Tata Consultancy Services, Infosys Technologies, and Wipro that it stands as a model for how to deal with the downside of globalization.

Accenture adapted quickly by combining the best aspects of the Indian offshoring approach with the company's primary activity, business consulting. By the end of Accenture's fiscal year this August, 35,000 of its 160,000 employees will be in India, where labor costs are less than half those in the U.S., up from only a handful in 2000. That formula not only allows it to compete with the Indian tech companies on price but also, just as important, combines the

company's tech knowhow, outsourcing, business consulting, and expertise in particular industries in a way that the Indians can't yet match.

Even Indian tech leaders are impressed. "At one time, I thought we'd be fortunate, and they wouldn't be able to deal with the shift. But they really embraced it," says Pramod Bhasin, chief executive of Genpact, the top player in Indian business process outsourcing.

One need look no further than De-

troit to see what disasters can befall a company when it's too set in its ways to recognize a mortal threat. In contrast, Accenture spotted the Indian upsurge early and responded quickly. To block Indian companies from getting foothold in its accounts, it took on lower-end jobs. And it invested heavily in new capabilities to stay ahead of rising competition.

Accenture's strategy is now being recognized as the preferred business model for the global tech services industry. Competitors, including the Indians, are scrambling to replicate it. "This gets companies away from competing on labor costs alone," says analyst Dana Stifter of AMR Research.

Accenture has long seen itself as a global organization. In 1985, as a unit of Andersen Worldwide, it established financial-services operations in Manila. "We have been operating a global virtual company for decades, so we had a lot of advantages other companies didn't have," says CEO Bill Green, a 30-year veteran. The consulting group split off from Andersen Worldwide in 2000 and went public a year later. The stock price has soared 140% since then. Goldman Sachs & Co. analyst Julio C. Quintero Jr. forecasts revenues of \$18.8 billion for this fiscal year, up 13%, and \$1.6 billion in profit, up 16%.

HARD TO MATCH

That IPO year was a turning point. Accenture already had large business consulting and tech services branches. But in 2001 top managers committed to aggressive expansion of their business process outsourcing unit, which handles human resources and accounting chores. They expanded rapidly in India and other low-cost countries and ran their far-flung service delivery centers as an integrated global network.

To see how Accenture is offering hard-to-match services, take a look inside the company's

Life Sciences Center of Excellence in Bangalore. The sprawling office building houses dozens of medical doctors, PhDs, pharmacists, math whizzes, and statisticians. They work alongside biologists to prepare clinical trial reports for the world's top drug companies.

These high-skill employees—all o



em Indian—coordinate closely with business consultants who are on site with clients around the world. Accenture consultants help clients revamp the way they handle the trials essential to getting new drugs approved by regulators. Once those processes are sharpened, Accenture software programmers in Bangalore design databases and algorithms for storing and analyzing clinical data. Accenture people distribute electronic forms to physicians to conduct the trials. Accenture's physicians review the data to spot errors and, when necessary, get on the phone with doctors conducting the trials. When all the data are collected, they analyze them for safety and effectiveness and write

reports. All told, Accenture has cut the average time to prepare reports from six months to a few weeks. Each day saved is worth about \$1 million to a drug company.

But just as important, one client, Wyeth Pharmaceuticals Inc., says it has been able to hand off huge chunks of work to a partner that can perform them even better than it can. "We are launching drugs that otherwise would have been held up by our inability to handle the work," says Robert R. Ruffalo Jr., Wyeth's president of research and development.

Accenture's Indian rivals are rapidly adding new capabilities, such as expertise in specific industries like pharma

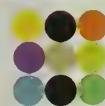
and retailing. Western corporations increasingly consider the best of the Indian firms when they reengineer how they do business. But Infosys and its Indian brethren have a long way to go to catch Accenture. It has 13,000 business consultants and announced plans on Mar. 19 to double that number over the next three years. Ruffalo, the Wyeth research boss, says he hired Accenture consultants to help out with most of the 70 "breakthrough" projects he has undertaken over the past five years. "There are a lot of good consulting companies out there, but [Accenture] knew us and understood us," he says. "We don't have to educate them again and again." ■

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Steak Chic

The new crop of steakhouses is hipper, but how's the meat? **BY JON FINE**



THE DECOR IS STRIKING AND PUNISHINGLY modern. The lighting is lemony; the banquettes are streamlined and low-slung. The side dishes are fussy. The gender split in the room approaches 50-50. The amuse-bouche is ambitious. That it is ultrarich and amply portioned is the sole giveaway that you're in a steakhouse. It's the 21st century, and restaurateurs realize there's money in toning down the traditional steakhouse's Y chromosomes. New entries backed by star chefs such as Tom Colicchio's Craftsteak, with branches in New York and Las Vegas, and Laurent Morel's BLT Steak and BLT Prime mini-empire (outposts in New York, Washington, D.C., and Puerto Rico) epitomize the breed, as do New York's Quality Meats and San Francisco's Lark Creek Steak. These places call for sharp looks, expansive menus, pricey wagyu options, and nouveau takes on dessert. (Hello, Craftsteak's red velvet cake—colored with beet juice, sandwiched around vanilla ice cream, and accompanied by sour cream. We're thinking of you. Wish you were here.) These joints are provenance-obsessed, eager to disclose that the salmon is organic and that the beef hails from Hawaii. They don't deliver a rush of pure bovine savor as satisfying as,

say, Brooklyn's century-old Peter Luger. But they do amp up nonbeef offerings well enough to be excellent ways to put the hurt on an expense account.

Just prepare for highs and lows. The amuse-bouche at BLT Prime—a rich, rosy chicken liver spread—made me regret all the terrible things I've ever said about liver. So it was strange when a gorgeous-looking bone-in double sirloin proved so meek and flavorless.

It took repeated visits to Craftsteak in Vegas and New York to find a winning strategy: Choose the most expensive options. As the finickiest of its school, Craft-

steak offers multiple tiers of aging for its steaks, from 28 days to 56 days. Only the 56-day option delivered the mineral tang, toothsome texture, and texture that seasoned steak freaks crave. At a price topping \$50—a premium on Craftsteak's already-pricey options—it had better. Craftsteak also purveys grass-fed steaks. They won't be mistaken for the corn-fed beef Americans grow up on. They're gamier, with a different flavored char and a less consistent chewiness. I enjoyed it, but it's not a given everyone will.

The most winning side dish: BLT Prime's broccoli rabe with white anchovies. Craftsteak's most outré offering—thinly scalloped potatoes browned in veal stock—was rich enough to resemble meat-flavored tarte tatin. You decide if that's good or bad; I was done in three bites.

Quality Meats proved the most reliable of the new breed: solid steaks, an industrial setting far cooler than the classic cow palaces, and a menu least prone to flights of fancy. It's not that the others won't make for a fine, well-wined night out, and it's great that their trimmings are terrific. But shouldn't the steak still be the thing? ■

A DIFFERENT CUT At Craftsteak in New York (opposite, top), the emphasis is on sharp looks, pricey menus, and nouveau takes on old favorites. A bovine bust (far left) greets patrons at Quality Meats, also in New York, which serves an artful steak tartare (opposite, below) along with the usual steak (left)

BusinessWeek weekend

TELEVISION: For a look at steakhouses that serve wagyu beef, watch *BusinessWeek Weekend* or go to www.businessweekweekend.com to see video clips.

WAGYU, THE FOIE GRAS OF STEAKS

IF YOU THINK PRICES for a tenderloin or a T-bone at fine steakhouses are steep, try ordering wagyu beef. Servings of the highly marbled delicacy, considered ambrosia for carnivores, might run as much as \$20 an ounce. Then again, because wagyu has a taste and texture more like foie gras than USDA prime steak, a small portion will do just fine.

The beef comes from Japanese cattle that are treated to regular massages and a diet of grains and beer, at least in Japan. Wagyu cattle are now raised in the U.S. and Australia,

although Kobe beef, considered the best of wagyu, comes from a specific region in Japan.

The Japanese typically eat wagyu in thin slices grilled rare or dipped in simmering broth, but chefs in the U.S. keep inventing ways to serve it. Kobe Club in New York offers "flights" that allow you to sample Kobe filet, strip loin, and rib eye. The price is \$395, but it's enough for two. At Cut in Los Angeles, chef Wolfgang Puck's signature dish is Kobe beef short ribs for a relatively modest \$39.

Others have given the pricey delicacy a more homey

touch. Thomas Keller has served wagyu meat loaf at Ad Hoc, a more casual spot near his famed French Laundry in Yountville, Calif. Ketchup, a sleek L.A. grill, features mini Kobe beef hot dogs (four for \$12), while a Kobe beef rib sloppy joe (\$15) graces the menu at newly opened Presidio Social Club in San Francisco. Why the growing popularity of wagyu? With caviar and foie gras under siege, says restaurant consultant Clark Wolf, "we need some luxury protein to help us feel special." —Amy Cortese



Bummed Out In Baggage Claim

The incidence of lost luggage is up dramatically. Here's how to speed recovery. **BY LAUREN YOUNG**

YOU KNOW YOUR TRIP is in trouble when only a trickle of suitcases from your flight arrives in baggage claim. Then the conveyor belt halts, never to start up again. Such was the welcome to Miami my husband and I and at least 50 other fliers received after a recent US Airways flight from Philadelphia. To make matters worse, there was just one beleaguered agent to process lost-luggage claims.

Unfortunately, this scene is being played out much too frequently. Complaints about lost, delayed, and damaged luggage are at an all-time high, according to the Transportation Dept. The most recent Airline Quality Rating report, issued by Wichita State University and the University of Nebraska at Omaha, found that 6.5 bags per 1,000 passengers were mishandled in 2006, compared with 4 per 1,000 in 2003.

Short of not checking your luggage in the first place, you can't do much to prevent it from going missing. However, you can take steps both before you board and after you find yourself bagless to improve the chances of recovery.

DO THE PAPERWORK

FOR STARTERS, use that camera in your cell phone to take a picture of your suitcase so you can give a good description. Monica Beaupre, a spokeswoman for American Express, says you should also put a copy of your itinerary in your bag. That way the airline can identify and find the owner even if the tags get separated from the luggage.

Pay careful attention when your bag is tagged at check-in, an obvious safeguard that many travelers overlook in their excitement or haste. "It only takes one key-



stroke to get the airport code wrong at the ticket counter," says Joe Brancatelli, editor of JoeSentMe, a business travel Web site.

What do you do when you arrive at the airport and your bags don't? "Never, ever leave until you file the appropriate paperwork and get copies," Brancatelli says. "The minute you leave, the airlines will say you forfeited your rights."

Instead of waiting on a long claims line in the baggage area, hightail it to the ticket counter, where the agents should be able to help. After you file your report, make sure you get the number for the local baggage claim counter. "Do not settle for the 800 number," Brancatelli says.

You can avoid a lot of the hassle if you have purchased a comprehensive travel

insurance plan such as one from Travel Guard, which will pay for essential items if your bag is delayed, and up to \$2,500 if the bag is gone for good. The most expensive policy is about 8% of the overall cost of your trip. Your credit card may come in handy, too. Issuers of certain American Express, MasterCard, Visa cards will hound the airlines at tracking down the lost bags.

NOW HEAR THIS

LET'S ASSUME the bags turn up, but items are missing. In the meantime, your trip was ruined by not having access to your prescriptions and your flattering bathing suit. How do you get compensated? Last December, Nar-

Bentley, a media relations specialist at billing services firm Convergint in Cincinnati, flew Delta Air Lines to New Delhi. Her bags never made it. During the business trip, which lasted 10 days, she spent meetings in dirty travel clothes and without tennis shoes. Once her luggage appeared, several flash drives worth \$150 were gone.

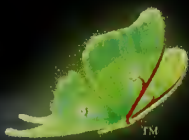
After returning home, Bentley faxed top officials at Delta demanding compensation for her \$8,000 tickets as well as for missing items. She copied members of the press. "It's a technique I've used when going through the regular customer-service channels haven't worked," Bentley says. Eight weeks later, she received 125,000

quent-flier miles and a check to cover the cost of the stolen items.

Although we were eventually reunited with our bags, I didn't put the matter to rest until I had e-mailed my dissatisfaction to US Airways' customer-service chief and Philadelphia operations manager from a personal e-mail account, not mentioning my media affiliation. For added impact, I included fellow passengers' e-mail addresses, which I collected while we were waiting in the lost-luggage line.

Within two weeks, US Airways had sent me \$1,200 in vouchers. Several fellow travelers told me they were compensated, too. It didn't make up for the hassle, but it felt like my voice was heard. ■

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IMPORTANT SAFETY INFORMATION: LUNESTA works quickly, and should be taken right before bed. Be sure you have at least eight hours to devote to sleep before becoming active. Until you know how you'll react to prescription LUNESTA, you should not drive or operate machinery. Do not use alcohol while taking LUNESTA. Most sleep medicines carry some risk of dependency. Side effects may include unpleasant taste, headache, drowsiness and dizziness. See important patient information on the next page.

Follow these two simple steps to get your 7 free tablets of LUNESTA:

STEP 1: Take this page to your doctor and ask if LUNESTA is right for you.

STEP 2: Present both your prescription and this page to your pharmacist for your
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Name: _____

Lunesta[™]

(eszopiclone)c
1, 2 AND 3 MG TABLETS

Please read this summary of information about LUNESTA before you talk to your doctor or start using LUNESTA. It is not meant to take the place of your doctor's instructions. If you have any questions about LUNESTA tablets, be sure to ask your doctor or pharmacist.

LUNESTA is used to treat different types of sleep problems, such as difficulty in falling asleep, difficulty in maintaining sleep during the night, and waking up too early in the morning. Most people with insomnia have more than one of these problems. You should take LUNESTA immediately before going to bed because of the risk of falling.

LUNESTA belongs to a group of medicines known as "hypnotics" or, simply, sleep medicines. There are many different sleep medicines available to help people sleep better. Insomnia is often transient and intermittent. It usually requires treatment for only a short time, usually 7 to 10 days up to 2 weeks. If your insomnia does not improve after 7 to 10 days of treatment, see your doctor, because it may be a sign of an underlying condition. Some people have chronic sleep problems that may require more prolonged use of sleep medicine. However, you should not use these medicines for long periods without talking with your doctor about the risks and benefits of prolonged use.

Side Effects

All medicines have side effects. The most common side effects of sleep medicines are:

- Drowsiness
- Dizziness
- Lightheadedness
- Difficulty with coordination

Sleep medicines can make you sleepy during the day. How drowsy you feel depends upon how your body reacts to the medicine, which sleep medicine you are taking, and how large a dose your doctor has prescribed. Daytime drowsiness is best avoided by taking the lowest dose possible that will still help you sleep at night. Your doctor will work with you to find the dose of LUNESTA that is best for you. Some people taking LUNESTA have reported next-day sleepiness.

To manage these side effects while you are taking this medicine:

- When you first start taking LUNESTA or any other sleep medicine, until you know whether the medicine will still have some effect on you the next day, use extreme care while doing anything that requires complete alertness, such as driving a car, operating machinery, or piloting an aircraft.
- Do not drink alcohol when you are taking LUNESTA or any sleep medicine. Alcohol can increase the side effects of LUNESTA or any other sleep medicine.
- Do not take any other medicines without asking your doctor first. This includes medicines you can buy without a prescription. Some medicines can cause drowsiness and are best avoided while taking LUNESTA.
- Always take the exact dose of LUNESTA prescribed by your doctor. Never change your dose without talking to your doctor first.

Special Concerns

There are some special problems that may occur while taking sleep medicines.

Memory Problems

Sleep medicines may cause a special type of memory loss or "amnesia." When this occurs, a person may not remember what has happened for several hours after taking the medicine. This is usually not a problem since most people fall asleep after taking the medicine. Memory loss can be a problem, however, when sleep medicines are taken while traveling, such as during an airplane flight and the person wakes up before the effect of the medicine is gone. This has been called "traveler's amnesia." Memory problems have been reported rarely by patients taking LUNESTA in clinical studies. In most cases, memory problems can be avoided if

you take LUNESTA only when you are able to get a full night of sleep before you need to be active again. Be sure to talk to your doctor if you think you are having memory problems.

Tolerance

When sleep medicines are used every night for more than a few weeks, they may lose their effectiveness in helping you sleep. This is known as "tolerance." Development of tolerance to LUNESTA was not observed in a clinical study of 6 months' duration. Insomnia is often transient and intermittent, and prolonged use of sleep medicines is generally not necessary. Some people, though, have chronic sleep problems that may require more prolonged use of sleep medicine. If your sleep problems continue, consult your doctor, who will determine whether other measures are needed to overcome your sleep problems.

Dependence

Sleep medicines can cause dependence in some people, especially when these medicines are used regularly for longer than a few weeks or at high doses. Dependence is the need to continue taking a medicine because stopping it is unpleasant.

When people develop dependence, stopping the medicine suddenly may cause unpleasant symptoms (see *Withdrawal* below). They may find they have to keep taking the medicine either at the prescribed dose or at increasing doses just to avoid withdrawal symptoms.

All people taking sleep medicines have some risk of becoming dependent on the medicine. However, people who have been dependent on alcohol or other drugs in the past may have a higher chance of becoming addicted to sleep medicines. This possibility must be considered before using these medicines for more than a few weeks. If you have been addicted to alcohol or drugs in the past, it is important to tell your doctor before starting LUNESTA or any sleep medicine.

Withdrawal

Withdrawal symptoms may occur when sleep medicines are stopped suddenly after being used daily for a long time. In some cases, these symptoms can occur even if the medicine has been used for only a week or two. In mild cases, withdrawal symptoms may include unpleasant feelings. In more severe cases, abdominal and muscle cramps, vomiting, sweating, shakiness, and, rarely, seizures may occur. These more severe withdrawal symptoms are very uncommon. Although withdrawal symptoms have not been observed in the relatively limited controlled trials experience with LUNESTA, there is, nevertheless, the risk of such events in association with the use of any sleep medicine.

Another problem that may occur when sleep medicines are stopped is known as "rebound insomnia." This means that a person may have more trouble sleeping the first few nights after the medicine is stopped than before starting the medicine. If you should experience rebound insomnia, do not get discouraged. This problem usually goes away on its own after 1 or 2 nights.

If you have been taking LUNESTA or any other sleep medicine for more than 1 or 2 weeks, do not stop taking it on your own. Always follow your doctor's directions.

Changes In Behavior And Thinking

Some people using sleep medicines have experienced unusual changes in their thinking and/or behavior. These effects are not common. However, they have included:

- More outgoing or aggressive behavior than normal
- Confusion
- Strange behavior
- Agitation
- Hallucinations
- Worsening of depression
- Suicidal thoughts

How often these effects occur depends on several factors, such as a person's general health, the use of other medicines, and which sleep medicine is being used. Clinical experience with LUNESTA suggests that it is rarely associated with these behavior changes.

It is also important to realize it is rarely clear whether these behavior changes are caused by the medicine, are caused by an

illness, or have occurred on their own. In fact, sleep problems that not improve may be due to illnesses that were present before the medicine was used. If you or your family notice any changes in your behavior, or if you have any unusual or disturbing thoughts call your doctor immediately.

Pregnancy And Breastfeeding

Sleep medicines may cause sedation or other potential effects on the unborn baby when used during the last weeks of pregnancy. Be sure to tell your doctor if you are pregnant, if you are planning to become pregnant, or if you become pregnant while taking LUNESTA.

In addition, a very small amount of LUNESTA may be present in breast milk after use of the medication. The effects of very small amounts of LUNESTA on an infant are not known, therefore, as with all other prescription sleep medicines, it is recommended that you not take LUNESTA if you are breastfeeding a baby.

Safe Use Of Sleep Medicines

To ensure the safe and effective use of LUNESTA or any other sleep medicine, you should observe the following cautions:

1. LUNESTA is a prescription medicine and should be used ONLY as directed by your doctor. Follow your doctor's instructions about how to take, when to take, and how long to take LUNESTA.
2. Never use LUNESTA or any other sleep medicine for longer than directed by your doctor.
3. If you notice any unusual and/or disturbing thoughts or behavior during treatment with LUNESTA or any other sleep medicine, contact your doctor.
4. Tell your doctor about any medicines you may be taking, including medicines you may buy without a prescription and herbal preparations. You should also tell your doctor if you drink alcohol. DO NOT use alcohol while taking LUNESTA or any other sleep medicine.
5. Do not take LUNESTA unless you are able to get 8 or more hours of sleep before you must be active again.
6. Do not increase the prescribed dose of LUNESTA or any other sleep medicine unless instructed by your doctor.
7. When you first start taking LUNESTA or any other sleep medicine, until you know whether the medicine will still have some effect on you the next day, use extreme care while doing anything that requires complete alertness, such as driving a car, operating machinery, or piloting an aircraft.
8. Be aware that you may have more sleeping problems the first night or two after stopping any sleep medicine.
9. Be sure to tell your doctor if you are pregnant, if you are planning to become pregnant, if you are breastfeeding a baby while taking LUNESTA.
10. As with all prescription medicines, never share LUNESTA or any other sleep medicine with anyone else. Always store LUNESTA or any other sleep medicine in its original container and out of reach of children.
11. Be sure to tell your doctor if you suffer from depression.
12. LUNESTA works very quickly. You should only take LUNESTA immediately before going to bed.
13. For LUNESTA to work best, you should not take it with immediately after a high-fat, heavy meal.
14. Some people, such as older adults (i.e., ages 65 and over) and people with liver disease, should start with the low dose (1 mg) of LUNESTA. Your doctor may choose to start therapy at 2 mg. In general, adults under age 65 should be treated with 2 or 3 mg.
15. Each tablet is a single dose; do not crush or break the tablet.

Note: This summary provides important information about LUNESTA. If you would like more information, ask your doctor or pharmacist to let you read the Prescribing Information and then discuss it with him or her.

Rx only



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Your acceptance of this offer must be consistent with the terms of any drug benefit provided by a health insurer, health plan, or other third-party payer, and you agree to report acceptance of this offer to your health insurer, health plan, or third-party payer as may be required.

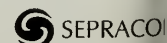
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BY ROBERT PARKER

Napa Wine, Bordeaux Character

CAN'T THINK OF ANYONE other than Christian Moueix who could claim to produce one of the greatest wines in France and one of the best in the U.S. For more than three decades, Moueix has been the winemaker for Bordeaux's renowned Château Pétrus, which is owned by his brother Jean-François. Since 1983, Moueix also has been the winemaker for Dominus Estate in California's Napa Valley and, since 1995, the estate's sole owner.

Moueix brings to Napa savoir faire, impeccable attention to detail, and classic Bordeaux winemaking techniques. He consistently produced wines with great smell, taste, and age like great Bordeaux. That is a remarkable achievement because Pétrus is virtually 100% cabernet, while Dominus is largely 80% cabernet sauvignon. Dominus' legendary vintages, if you never find any on a restaurant wine list, are the 1990, 1991, 1994, 1997, 2000, and 2002, but everything from his winery is of high quality. The following are tasting notes for the most recent vintages.

2001 Dominus
94 points. The impeccably made 2001 (81% cabernet sauvignon, 10% cabernet franc, 5% merlot, and 5% petit verdot) boasts a dark plum/purple color in addition to a slight perfume of cocoa, cedar, coffee, and herbs, and black fruits. Rich and medium- to full-bodied, with sweet but firm tannin, a layered mid-palate, and a long finish, it will require three to five years of cellaring. It should last for two decades. \$90-\$145

2002 Dominus
96 points. The estate made 4,800 cases of this blend (88% cabernet sauvignon, 7% cabernet franc, and 5% petit verdot). A big, racy nose of roasted coffee, Provençal black currants, cherry jam, plums, spice, and forest floor is followed by a



MOUEIX
Dominus
wines are all
cab blends

spicy, rich, full-bodied, fragrant, intense wine. Anticipated maturity: 2007-2025. \$95-\$100

2002 Dominus
96 points. The deep, saturated purple-colored 2002 boasts an extraordinary perfume of roasted coffee intermixed with black currants, cherries, cocoa, cedar, cigar smoke, and new saddle leather. A classic, full-bodied palate possesses great structure, tremendous depth, loads of tannin, and a multilayered, concentrated, yet elegant finish. It needs three to five years of bottle aging and should last for 25 years. \$100-\$140

2004 Dominus
94 points. The elegant, dark plum/purple/garnet-colored 2004 exhibits a big, sweet perfume with cedar, mocha, black cherry liqueur, and black currant notes. It is medium- to full-bodied with silky tannin as well as a luscious mouthfeel and finish. This wine should be more accessible in its youth than many of its predecessors but ought to last for two decades. It will be released in June. ■

Robert Parker is the world's most influential wine critic. Visit eRobertParker.com to see tens of thousands of tasting notes, buy his books, or subscribe to his newsletter, The Wine Advocate.

Rated from 96-100 are extraordinary; 90-95, excellent; 80-89, above average to very good. For more Parker picks, go to businessweek.com/extras.

The High Price of Free Insurance

Deals that fund, then buy out, big life policies may shortchange seniors. **BY ANNE TERGESEN**

THE DEAL OFFERED TO affluent seniors sounds awfully good: two years of free life insurance, plus a luxury car, a cruise, or a cash payment. All you have to do is take out a multimillion-dollar life insurance policy with a loan you're not obligated to repay and sell or transfer the policy in a couple of years. 

The buyers? Small investment firms, which package and sell the policies to hedge funds, investment banks, and pension funds. The investors continue to pay the premiums and cash in on the death benefits when the insured seniors die. They see life insurance policies as desirable assets because the expected returns—about 13% a year, according to one study—don't correlate with returns from the stock or bond markets. While some firms have for years stood ready to buy policies that people no longer want or need, not enough come over the transom to feed institutional investors' growing appetite. So, some enterprising investment firms are trying to expand the pool available for sale by recruiting seniors to sign up for policies. Pitches for such deals have become "commonplace in affluent communities of seniors," says J. Alan Jensen, a partner at Holland & Knight in Portland, Ore., which has represented high-net-worth clients in these transactions. The marketing materials make these arrangements sound like a

sure thing. "You have literally no risk," claims one brochure.

Not exactly. Seniors entering these insurance arrangements could get stuck with significant tax or legal bills if the deals don't work out as advertised. "Nowhere in the hype will you learn of the potential tax liabilities or the fact that anticipated profits may not materialize," says Jensen. There are other risks, too. For example, if you sell a policy and then decide later that you need additional insurance, you could find you've used up all of the coverage an insurance company will sell you.

Lawmakers and insurance regulators have started to examine these deals. In recent months insurance commission-

ers in New York, Utah, Idaho, Louisiana have concluded that of them violate state laws designed to protect consumers from strangers want to bet on their lives. Lawmakers in at least five states are backing that would regulate or outlaw insurance deals initiated and finalized by investors. Insurance commission-





cyholders will drop their coverage as financial or personal circumstances change. But as investors intent on collecting death benefits amass policies, insurers worry they'll have to pay benefits on a greater number of policies than their actuarial models anticipated. To make these deals less appealing, American International Group recently hiked the cost of a universal life policy—the variety typically used—by 15% for those over age 70, says spokesman Chris Winans. Other insurers have rescinded policies. MetLife Inc. has gone after policyholders for allegedly violating signed statements in their applications. “It clearly asks them to attest that they are not purchasing with the intent to resell,” says spokeswoman Holly Sheffer.

The transactions often work like this: Insurance brokers, attorneys, and other promoters arrange for high-net-worth seniors to apply for multimillion-dollar life insurance policies paid for with loans from the promoters and other lenders. A senior isn't typically required to put up any cash or collateral aside from the policy itself. If the insured dies in the policy's first two years, the heirs are entitled to keep the death benefit so long as they repay the loan and interest. Otherwise, when the loan comes due, the policyholder must pay it off from personal funds or sell the policy to investors.

If a sale generates more than what's needed to retire the loan, the senior can pocket the excess. If a sale won't cover the loan, the senior simply signs the policy over to the lender and walks away.

Still, the gains may be significantly less than the promoters claim. Interest payments, lenders' fees, and brokers'

commissions can take a big bite out of policyholders' profits. John Shannon, an 82-year-old Arizona resident, discovered that when his \$4.4 million policy was sold last October for \$1.1 million. Once the loan that financed the policy's premiums was repaid, Shannon was left with \$361,256, according to court documents in the lawsuit Shannon filed over the sale. Worse, the terms of the deal required him to hand over 51% of the remaining funds, almost \$200,000, to the lender and promoter, Cove Management of La Jolla, Calif. The two sides settled for an undisclosed sum. “The people who put these deals together see there's profit to be made, and they do their best to take it all,” says Thomas David, a Miami attorney who represented Shannon. Dan Miller, manager of Cove Management, counters that Cove clearly discloses its 51% fee and only levies it when policyholders choose to sell their policies rather than repay their loans. “Ninety-nine percent of our

How It Works

Promoters are offering wealthy seniors two years of free life insurance, plus bonuses, including luxury cars, cruises, or cash.

- 1) A SENIOR** citizen applies for life insurance
- 2) TO PAY** the premiums, the senior borrows from a lender, who often is the promoter, using the policy as collateral
- 3) WHEN THE** loan comes due—typically in two years—the senior pays it back from personal funds or sells the policy to the promoter or other investors
- 4) IF THE POLICY** fetches more than enough to repay the loan and transaction fees, the senior keeps the excess
- 5) IF THE POLICY** won't generate enough, the senior signs the policy over to the lender, and the debt is forgiven

customers are very happy.”

Shannon's situation isn't unusual. Typically, those who sell policies receive about 20% to 30% of the death benefit. For a \$1 million policy belonging to someone with a life expectancy of seven years, a purchaser might pay \$250,000, says Adam Balinsky, a partner at Baker & McKenzie in Toronto. But after

so pushing states to enact laws reg-
g policyholders who participate
t five years before selling policies
estors vs. today's two-year delay.
insurance companies are cracking
too—in part because they fear
arrangements will depress prof-
then insurers set premiums, they
assume a certain number of poli-

paying various fees to middlemen that buy policies, the seller would be likely to take home only about \$150,000, he calculates. From those proceeds, the seller would have to repay the loan plus various lender fees and interest of 12% to 18%. In the end, the insured might only net about \$42,000, Balinsky figures.

Sign-up goodies such as cars incur income tax

Moreover, because the market isn't transparent, it's hard for those who sell policies to know whether they're getting a good price. Brokers are supposed to act in the interests of clients. But New York Governor Eliot Spitzer (while still serving as the state's Attorney General) last year brought fraud charges against Coventry First, a Philadelphia leader in buying life insurance policies, for allegedly making secret payments to brokers to suppress competitive offers from Coventry's competitors. Coventry has filed a motion to dismiss the suit. "It is entirely without merit," a spokesman says.

There are also thorny tax issues. Because the tax code doesn't specifically address such deals, the rules that apply aren't always clear. Those who profit may forfeit a significant chunk of their gains to the Internal Revenue Service. For example, seniors who receive cash, cars, or other sign-up bonuses must pay income tax on the value of those goodies. Those who sell their policies are required to pay tax on the gains. It's not certain whether ordinary-income or capital-gains tax rates apply, says Stephan Leimberg of Leimberg Information Services, a publisher of newsletters for tax and estate planning professionals.

There may even be a tax liability if the sale price for a policy falls short of the loan that financed it. Although a senior can always satisfy the loan by turning the policy over to the lender, the IRS could levy income tax on at least some of the amount of debt forgiven. A senior might also have to pay tax on the two years of "free" insurance benefits he or she received. In such a situation, a policyholder could sustain a loss. So much for the free life insurance pitch. ■



LIVING
The Ragans want to buy a bigger home.

Meet the Parents-Backed Mortgage

Shared equity financing lets mom and dad help and maybe profit. **BY CHRISTOPHER FARRELL**

DAVID RAGAN AND HIS wife, Jocelyn, own a starter home they bought three years ago for \$125,000 in a new subdivision in a rural area some 15 miles outside of Denton, Tex. Since then, their children—James, 2, and McKenna, seven months—have joined them, and the house is getting crowded. The Ragans would like a bigger home in a more established neighborhood in Denton with good schools. Such a house might cost at least \$180,000, which is a stretch.

So Ragan, a certified financial planner, is working out a deal with his fa-

ther, Gerry, who will become an investor in his yet-to-be-purchased home. The agreement, called a shared equity financing arrangement or a shared equity mortgage, is an increasingly popular way for family members, usually parents, to help their children meet today's home prices.

The final terms still need to be worked out, but this is the framework: Dad will put \$50,000 into the down payment on the Ragans' new home. The Ragans may add to it depending on the proceeds of the sale of their current home. Either way, the equity sharing arrangement will allow the couple to purchase the expensive place without stretching their finances. Dad will get his invest-

Some think
barren.

**We think
source.**

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back plus a share of the appreciation determined by his stake in the purchase price. If the Ragans buy a \$200,000 home, then dad's \$50,000 investment gets him 25% of the gain. "This allows my family to live in a better neighborhood that we could not have otherwise afforded," says Ragan. "It allows my father to participate in real estate appreciation without going out and purchasing something himself."

True, home prices are down 2% nationally over the past 15 months, but that hardly makes housing more affordable for young families. The nation's median home price has doubled since 1993, to \$212,800, and in many parts of the country the figure is much higher. For instance, in San Francisco and Oakland the median price of a home is \$737,000. The comparable figure for the New York City metropolitan area is \$470,000. Even in Denton County, Tex., it's just shy of \$159,000. "We have a lot of older clients who say they're interested in helping out their kids," says Jared Roskelley, a certified financial planner in Scottsdale, Ariz. "And the kids tell us they're interested in getting help from their parents."

A SAFER BET

THE SHARED EQUITY deals can be a prudent alternative to some of the more creative financing techniques of recent years. Many young homeowners who took on interest-only mortgages, piggyback loans, option adjustable-rate mortgages, and other such gimmicky products are finding themselves financially stretched as the cheaper teaser rates expire and higher market rates kick in.

Making the Deal

What to bear in mind when putting together a shared equity arrangement.

GET EVERYTHING in writing so there is no ambiguity in the family.

A SHARED EQUITY investment should be considered part of an overall estate plan.

SET AN end date for the deal. The typical range is 3 to 10 years.

PARENTS: Understand that it probably won't be a great investment.

KIDS: Remember, you'll be in business with mom and dad.

In sharp contrast, equity-sharing deals offer the homeowner a fiscally conservative package. Investors, usually parents, typically put in cash to allow the buyers to amass a down payment of at least 20%. That allows buyers to qualify for a conventional 30-year, fixed-rate mortgage (table). The equity sharers get back their initial stake plus 10% to 50% of the profits.

These deals are flexible. Typically, a written contract spells out that the homeowner is responsible for mortgage payments and gets the tax deduction that comes with it. Who pays the property taxes needs to be worked out between the homeowner and investor. (Ragan and his dad plan to split them 50-50.) Many equity lenders insist on an end date,

when the investment will be paid either through a sale or a refinance.

In some cases, the parent's name is on the loan, and in others it isn't. In instance, Ragan's father's won't be on the mortgage, and their agreement include a date for dad to get his name back. "Everything is open to negotiation," says Virginia Gerhart, a certified financial planner in Northern California's Marin County. "That's why you should have an attorney involved."

Indeed, parents and children need to exercise caution. For one thing, advisors say parents shouldn't even think about vesting this way if it means putting retirement funds at risk. There's also the chance of no appreciation. Most important, parents shouldn't let their emotions cloud their financial judgment.

The price of love can be steep. At the experience of one of Roskelley's clients. She's a 60-year-old divorced woman living on investment income. Several years ago she gave her daughter \$40,000 as a down payment for a first home. Her mother expected that she would get back the \$40,000 plus 20% of the profit when the home was sold, but the agreement wasn't in writing. A few years later the daughter sold the home, but instead of repaying her mother she loaned money to her boyfriend, who was starting a business. The relationship ended in a bust, as did his business, and no money was recovered. The arrangement, Roskelley, "left the mother and daughter at odds with each other."

At the moment, shared equity arrangements are largely ad hoc legal agreements negotiated between well-off parents and their young adult children. There was an attempt in the 1970s to popularize "shared appreciation mortgages," but they never took off because the terms were unfavorable to investors.

In the next couple of years a more formalized shared equity arrangement could get new life. At least that's the vision motivating real estate scholar and economist Andrew Caplin of New York University. He and a number of other experts are designing standard shared equity mortgages that would allow outside investors to buy a share of the equity gain. Caplin estimates that about 25% of first-time home buyers could find such arrangements attractive. When they do come along, investors will extract stiffer returns than mom or dad.

In the meantime, well-heeled families continue to negotiate their own deals. Done right, it's win-win financing.

Sharing the Equity

Here's how an investor, usually a parent, can help family members with home purchases.

BUYING THE HOUSE

Purchase price: \$500,000

Investors provide 20% down payment: \$100,000

Homeowner makes monthly payment on 30-year, 6% fixed-rate mortgage: \$2,398

The agreement stipulates that at the end of 10 years the investors get their \$100,000 back plus 20% of appreciation

SELLING THE HOUSE

Annual price appreciation over 10 years: 5%

Home sale price: \$814,447

Mortgage outstanding: \$334,702

Amount remaining after paying off mortgage: \$479,745

Investor gets money back: \$100,000

Investor gets 20% of appreciation: \$62,889

Homeowner's net: \$316,856

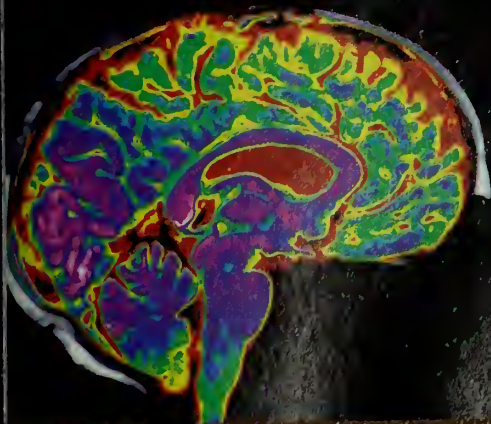
Data: BusinessWeek

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BY GENE G. MARCIAL

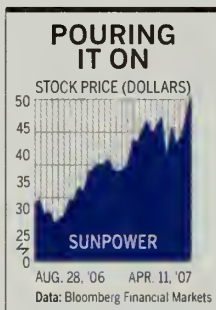
INVESTORS ARE BETTING ON CLEAN ENERGY FROM **SUNPOWER**

AVALON HAS A BIG-PHARMA DEAL FOR TESTING CANCER DRUG

HELPING POWER PLANTS CURB EMISSIONS: GEAR FROM **ADA-ES**

SunPower Shines Bright

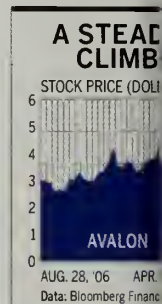
SUNPOWER (SPWR) HAS CAPTIVATED investors seeking clean-energy plays, causing the stock to double, from 24 in July to 50.46 on Apr. 11. The company makes high-efficiency silicon solar cells and panels that generate electricity from sunlight. SunPower should be a part of any "clean-energy portfolio," says Michael Carboy of investment outfit Signal Hill Capital Group, who rates the stock a buy. One of SunPower's attractions is its galloping sales growth in the past four years, from \$5 million in 2003 to \$236 million in 2006. And earnings at SunPower, which was spun off by Cypress Semiconductor in 2005, are expected to double, from 51¢ a share in 2006 to 98¢ in 2007, and again, to \$2 in 2008, figures Carboy. Cypress acquired SunPower in 2004 and still owns 69% after the spin-off. Carboy sees sales hitting \$680.2 million in 2007 and \$1.2 billion in 2008. Apart from its explosive sales and earnings growth, SunPower's "tremendous franchise strength and crisp execution appeal strongly to us," says Carboy. David Edwards of ThinkEquity Partners, who also rates SunPower a buy, says it ranks tops in what he looks for: people, product, potential, and predictability. SunPower's five-year outlook, says Edwards, prompted him to raise his 12-month target from 50 to 60.



Avalon's New Lab Partner: Merck

AVALON PHARMACEUTICALS (AVRX), a little-known biopharma focusing on small-molecule therapeutics for cancer, has teamed up with Big Pharma, including Merck, for the use of its AvalonRx drug discovery system. On Mar. 6, Merck signed a pact to use AvalonRx to screen selected Merck compounds to identify inhibitors against an undisclosed target essential for the development of cancer. Avalon could receive up to \$200 million in various milestone payments, plus royalties on products. Ren Benjamin of Rodman & Renshaw, who rates Avalon "outperform/speculative," says he is encouraged that the value of AvalonRx technology "is being recognized by the large pharma companies." Avalon, with 2006 sales of just \$2.7 million, previously signed pacts with Novartis, MedImmune, and Medarex. Avalon's agreement with Merck "should result in identifying first-in-

class drug candidates," says Avalon CEO Kenneth Carter. He expects one more Big Pharma to sign up next year. Avalon also makes drugs and its lead product, AVN944, now in Phase 1 trials, aims to inhibit growth of tumor cells, including myeloma, colon, and lung. Patrick Flanagan of WR Hambrecht (it did banking for Avalon) says AVN944 could see peak sales of \$500 million. He rates Avalon, trading at 4.67, a buy, with a year's target of 13.



Tougher Pollution Rules Are Buoying ADA-ES

CONTROL OF CARBON EMISSIONS from coal-fired plants has long been a hot topic, but states are now slapping limits on mercury output, too. And investors are watching. Illinois O.K.'d a regulation in December that requires power plants to retrofit activated carbon injection the state's 56 boilers during 2008-09. "We're getting a lot of orders these days," says Michael Durham, president of ADA (ADES), which provides technology and equipment that help coal plants enhance existing pollution-control systems and improve their efficiency. Today, 12 states have mercury-control rules, and an additional 13 are considering regulations stricter than the existing federal Clean Air Mercury Rule. John Quealy of investment firm Canaccord Adams, who rates ADA-ES a buy, says state legislation is the primary impetus for adopting mercury control systems. That produced solid fourth-quarter results for ADA-ES. The strong sales in its mercury-emission-control unit provided most of the oomph. He sees the stock, now at hitting 20 in a year. Another bull, William Burns of investment firm Johnson Rice, expects the mercury-control market to grow by 2010. He forecasts earnings of 11¢ a share in 2007 and 1.20¢ in 2008, up from 2006's 7¢. ■



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UTC Power's fuel cell
powering a hybrid-electric bus



The ultimate power trip.

A fuel cell is an electrochemical device that combines hydrogen and oxygen to produce nothing but electricity, heat and water pure enough to drink.

Doing more with less.

This fuel cell bus is twice as fuel efficient as a diesel and operates for 350 miles without a fill-up. That's two days of travel for a normal city bus.

Don't miss the bus.

UTC fuel cells are ready to go. Right now. They have already helped transport more than 200,000 Californians to a cleaner world.

"I'll be there in 10 minutes."

There is no diesel engine, so it's as quiet as a luxury sedan. In fact, a bus driver in the front can hear you on your cell phone in the back.

Replacing one diesel bus = the environmental benefits of planting 31 acres of forest and eliminating the NO_x (nitrogen oxides) emissions from 77 cars.

Goodbye dipstick.

A fuel cell has no moving parts. No friction, no wear, no oil (or oil changes).

It's a bus! It's a generator!

It's a bus!
This bus can power a small office building in a blackout. Talk about emergency preparedness.

Wherever it's critical.

We don't provide fuel cells just for buses and manned space flight. We have them for cars, hotels, hospitals, universities, office buildings, even the New York City Central Park Police Station.

Supply, supply, supply and demand.
Hydrogen is the most plentiful element on earth.

Ham & cheese
(Bus drivers need fuel too.)

Bike rack

High voltage batteries

From the moon to the mall.
UTC Power's fuel cells were first used in the Apollo space program and have been on every American manned space flight since. Today we fit 10 times the power into the same size unit.

Accessory drive system

Electric drive motor

ZERO EMISSION HYDROGEN FUEL CELL BUS

Hydrogen tanks

A/C system

Fuel cell cooling system

Steam exhaust
(That's it! Just evaporated water, nothing more!)

$H_2 + \frac{1}{2} O_2 \rightarrow H_2O + \text{electricity} + \text{heat}$

PureMotion™ 120
fuel cell power system

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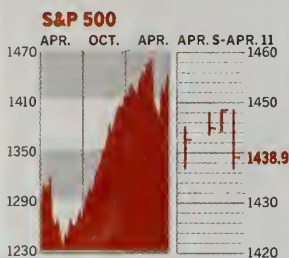
United Technologies has reduced energy consumption measured in Btu's by 19% over the last decade, on a company more than twice the size. We make more efficient products, like elevators that use 70% less energy and fuel cell buses whose emissions are water and waste heat, and nothing more. United Technologies: the 47.8 billion dollar company that proves you can be as conscientious as you are competitive at every turn. Learn more at utc.com/curious.



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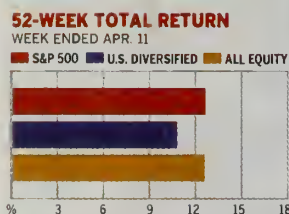
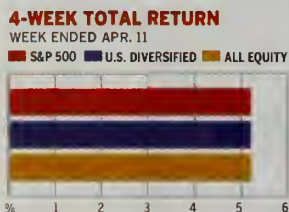


COMMENTARY

The just-released minutes from the last Fed meeting put the kibosh on the markets; not surprisingly, the central bank's concerns over slowing growth and stubborn inflation made investors jittery. Like baseball, earnings season also opened: Alcoa climbed 1.3% on better-than-expected profits. Intel jumped after rival AMD announced a restructuring.

Data: Bloomberg Financial Markets, Reuters

MUTUAL FUNDS



Data: Standard & Poor's

U.S. MARKETS

	APR. 11	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
S&P 500	1438.9	0.0	1.5	11.8
Dow Jones Industrials	12,484.6	-0.4	0.2	12.6
NASDAQ Composite	2459.3	0.0	1.8	6.4
S&P MidCap 400	860.3	0.1	7.0	10.1
S&P SmallCap 600	416.1	-0.2	4.0	8.2
DJ Wilshire 5000	14,538.4	0.0	2.3	11.9

SECTORS

		WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
BusinessWeek 50*	808.8	-0.7	1.3	4.3
BW Info Tech 100**	453.0	0.2	1.2	14.1
S&P/Citigroup Growth	659.8	-0.1	1.1	9.2
S&P/Citigroup Value	777.8	0.0	1.8	14.5
S&P Energy	476.5	0.8	4.6	14.8
S&P Financials	478.4	-0.4	-3.4	10.0
S&P REIT	204.6	-1.2	2.9	24.0
S&P Transportation	271.7	1.8	3.0	-3.3
S&P Utilities	207.5	0.8	11.2	34.9
GSTI Internet	210.0	0.0	5.1	8.0
PSE Technology	895.2	-0.2	2.2	3.6

*March 19, 1999=1000 **February 7, 2000=1000

GLOBAL MARKETS

	APR. 11	WEEK	% CHANGE YEAR TO DATE
S&P Euro Plus (U.S. Dollar)	2131.9	1.2	7.1
London (FT-SE 100)	6413.3	0.8	3.1
Paris (CAC 40)	5751.9	0.2	3.8
Frankfurt (DAX)	7152.8	1.1	8.4
Tokyo (NIKKEI 225)	17,670.1	0.7	2.6
Hong Kong (Hang Seng)	20,449.4	1.2	2.4
Toronto (S&P/TSX Composite)	13,401.0	-0.4	3.8
Mexico City (IPC)	29,278.8	-0.3	10.7

FUNDAMENTALS

	APR. 10	WEEK AGO	YE
S&P 500 Dividend Yield	1.82%	1.81%	
S&P 500 P/E Ratio (Trailing 12 mos.)	17.3	17.2	
S&P 500 P/E Ratio (Next 12 mos.)*	15.0	14.8	
First Call Earnings Surprise*	12.50%	15.07%	1

TECHNICAL INDICATORS

	APR. 10	WEEK AGO	YE
S&P 500 200-day average	1364.7	1360.8	Pr
Stocks above 200-day average	76.0%	74.0%	Ne
Options: Put/call ratio	0.82	1.08	Pr
Insiders: Vickers NYSE Sell/buy ratio	6.04	6.47	Ne

BEST-PERFORMING GROUPS

	LAST MONTH %		LAST 12 MONTHS %
Divsfd. Metals & Mining	17.7	Tires & Rubber	148.1
Tires & Rubber	16.5	Divsfd. Metals & Mining	50.1
Coal	15.5	Power & Energy Traders	49.0
Health-Care Facilities	12.4	Steel	44.9
Oil & Gas Refining	12.1	Leisure Products	39.0

WORST-PERFORMING GROUPS

	LAST MONTH %		LAST 12 MONTHS %
Employment Services	-12.5	Homebuilding	
Homebuilding	-12.2	Electric Mfg. Svcs.	
Forest Products	-9.1	Education Services	
Electric Mfg. Svcs.	-9.1	Gold Mining	
Education Services	-8.3	Photographic Products	

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Latin America	14.1	Utilities	36.4
Precious Metals	10.9	Latin America	35.9
Natural Resources	9.9	Pacific/Asia ex-Japan	29.8
Diversified Emerging Mkts.	9.1	Real Estate	28.4
LAGGARDS		LAGGARDS	
Japan	1.0	Japan	-5.6
Domestic Hybrid	3.1	Technology	4.2
Real Estate	3.3	Small-cap Growth	5.7
Financial	3.4	Large-cap Growth	7.6

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
DireXn. Lat. Am. Bull 2X Inv.	28.1	ProFds. Utilities Ultrasector	54.7
ProShares Ultra Oil & Gas	22.4	Dreyfus Prem. Grtr. China A	54.3
DireXn. Emrg. Mkts. Bull 2X	22.3	iShares MSCI Malaysia Idx.	53.5
ProFunds UltraEmrg. Mkts.	21.2	iShares MSCI Singapore Idx.	52.3
LAGGARDS		LAGGARDS	
DireXn. Emrg. Mkts. Short	-19.1	DireXn. Emrg. Mkts. Short	-42.1
ProShares UltSh. Oil & Gas	-18.4	American Heritage Grth.	-40.0
ProFunds UltSh. Emrg. Mkts.	-18.2	DireXn. Dev. Mkts. Bear 2X	-29.8
ProShares UltSh. Utilities	-14.8	SPDR S&P Homebuilders ETF	-26.4

INTEREST RATES

	APR. 11	WEEK AGO	YE
KEY RATES			
Money Market Funds	4.87%	4.87%	
90-Day Treasury Bills	5.02	5.04	
2-Year Treasury Notes	4.72	4.59	
10-Year Treasury Notes	4.74	4.65	
30-Year Treasury Bonds	4.91	4.84	
30-Year Fixed Mortgage †	6.20	6.08	

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND	30-YR.
General Obligations	3.90%	4.00%
Taxable Equivalent	5.57	6.00
Insured Revenue Bonds	4.04	4.00
Taxable Equivalent	5.77	6.00

THE WEEK AHEAD

RETAIL SALES Monday, Apr. 16, 8:30 a.m. EDT » March retail sales are expected to grow 0.4%, after edging up 0.1% in February. That's the median estimates of economists queried by Action Economics. Sales minus vehicles likely grew 0.6%, after a 0.1% dip.

BUSINESS INVENTORIES Monday, Apr. 16, 10 a.m. EDT » Inventory levels most likely grew 0.3% in February, after a 0.2% rise in January.

CONSUMER PRICE INDEX Tuesday, Apr. 17, 8:30 a.m. EDT » March prices likely zipped up 0.6% on higher energy prices, after a 0.4% February gain. Minus energy and food, the index probably rose 0.2% for a second straight month.

RESIDENTIAL CONSTRUCTION Tuesday, Apr. 17, 8:30 a.m. EDT » March housing starts very likely eased to an annual rate of 1.5 million. Starts jumped to a 1.53 million rate in February.

INDUSTRIAL PRODUCTION Tuesday, Apr. 17, 9:15 a.m. EDT » March factory output probably inched up 0.1%, after a 1% surge in February. The capacity utilization rate is expected to have slipped to 81.9%, from 82%.

LEADING INDICATORS Thursday, Apr. 19, 10 a.m. EDT » The Conference Board's March leading economic indicators index probably held steady, after a 0.5% drop in February.

The BusinessWeek Production Index edged up to 291.9 for the week ended Mar. 31, a 7.9% gain from year ago. Before calculation of the four-week moving average, the index declined to 292.

BusinessWeek .com

For the BW50, more investment data, and the components of the production index visit www.businessweek.com/extras.

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This index gives the starting page for a story or feature with a significant reference to a company. Most subsidiaries are indexed under their own names. Companies listed only in tables are not included.

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A Blast from Iacocca

WHERE HAVE ALL THE LEADERS GONE?

By Lee Iacocca; Scribner; 274pp; \$25

It was probably asking too much: Could ex-Chrysler chief Lee Iacocca, now 82, who hasn't been the high-profile head of a big company for more than 14 years, put together a book that would provide valuable leadership advice to America's politicians and CEOs?

That's the mission taken on by Lido, as he has been called since childhood, in *Where Have All the Leaders Gone?* Anyone expecting a volume strictly focused on corporate leadership, with tips on managing a complex corporation, will be disappointed. Instead, Iacocca devotes far too many pages to an attack on everything from President George W. Bush and the nation's schools to the health-care system, obesity, and America's pill-popping culture. The book often comes off as a rant by someone who remembers an America that was so much better during his salad days. Still, it does contain sound advice on the qualities of good leaders and provides real examples, past and present, of effective leadership. Unfortunately, those passages appear infrequently.

The author starts with a no-holds-barred assault on the Bush White House and Washington in general that goes on for about 100 pages. The criticism is sharp, but a lot of this ground is well-trod. Iacocca joins a growing chorus of business conservatives who are distancing themselves from the current Administration. If one is looking for criticism of the Right by the Right, recent books by such intellectuals as Kevin Phillips offer much more heft.

All the same, Iacocca's lambasting of Bush does tell leaders what not to do. Applying his "Nine Cs of Leadership" test, Iacocca finds the President to be flawed in nearly all respects. Bush, Iacocca says, lacks the Curiosity to seek opinions outside his inner circle. He isn't Creative enough to admit when something isn't working and try a different course. His Communication consists of selling his failures as "not really as bad as they seem." Character is the fourth C, and Bush showed a lack of it by sending troops into Iraq for questionable reasons.

What should a good leader do? In many cases, Iacocca says, it's what he himself did. His advice to the current heads of Detroit's automakers is mostly based on his steps to straighten out Chrysler, starting in 1979. To get employees of America's beleaguered car companies behind a turnaround, Iacocca says, there must be "equity of sacrifice." Recalling

his days at Chrysler, he writes: "I cut my salary to one dollar a year. That is an example of leadership born in a crisis." But he's hardly alone in making such a suggestion. More than a year ago his former chief financial officer, Jerome L. York, who was about to begin a short stint on the board of General Motors Corp., declared that the company should stockholder dividends and executive salaries.

The best parts of the book are when Lido isn't fulminating on Bush's failures or recalling his own triumphs. Iacocca shines with stories of the managers who inspired him. Early on, as a regional sales manager for Ford, his first mentor, sales executive Charlie Beacham, sent Iacocca, with his master's

degree in engineering, to sell used trucks in a small-town Pennsylvania. Iacocca says he hated the job, but it taught him the value of sending up-and-coming talent into the trenches to learn the business. That's another one of Iacocca's nine Cs—Common sense.

In another example, Iacocca talks about how he learned managerial discipline from Ford President Robert McNamara. Iacocca's strong suit was always Charisma and salesmanship. McNamara told him it wasn't enough: Iacocca needed to be able to show why his ideas would work concretely via written analysis. Iacocca says McNamara taught him a lot, notably that all good executives must be mentors.

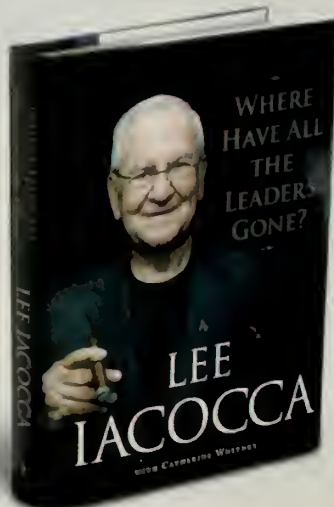
Today's leaders, including those in Detroit, must adopt another C—Courage

and make some hard decisions, he says. Iacocca offers sage advice for any company in trouble: Simple. Detroit needs to sell or discontinue some brands and regain focus. U.S. carmakers should also stop relying on sport-utility vehicles and build small cars. The oil shock of the '70s should have been a wake-up call, he writes.

Of course, such observations are hindsight. While Iacocca now advocates tougher fuel

economy standards and smaller cars, he is also the man who bought American Motors to get its Jeep Div. and profited hugely from America's love affair with SUVs. And he added the Eagle car brand, which Chrysler ditched post-Lido in order to simplify. Therein lies a problem: Iacocca brings a fair bit of wisdom to the discussion of leadership, but sometimes he tells today's leaders to do as he says, not as he did. ■

—By David W.



Nuggets of sound advice buried in a rant about how badly those in power have blown it



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WITH MARIA BARTIROMO

Sam Zell, Media Mogul

ONE DAY YOU'RE sitting atop a real estate empire. A couple of months later, you're a media mogul presiding over a news kingdom studded with such crown jewels as the *Los Angeles Times*, the *Chicago Tribune*, *Newsday*, and *The Baltimore Sun*. Life is good for Sam Zell. Hard on the heels of the sale of Equity Office Properties for \$39 billion, he has won control of Tribune Co. for a chump-change downpayment of \$315 million. On Apr. 6, I caught up with this outspoken iconoclast to see where he plans to take one of the most but-toned-up companies in America.

The word is you're meeting with David Geffen to discuss the sale of the L.A. Times. Are you expecting to sell it?

I am having dinner with David Geffen tonight. The purpose of the dinner has nothing to do with the *L.A. Times*. I am looking forward to having dinner free of business after what has been a tough week...I have no intention of selling the *L.A. Times*. Period. End of speech.

Would you consider selling the Tribune newspapers in Baltimore or New York to local groups?

I don't have any plans to sell any newspapers. We're going to own all of the newspapers for the foreseeable future.

Do you see a need to downsize the staff at any of the papers?

I don't have enough information at this point to answer that.

Tribune's broadcasting operations have been disappointing, so what changes do you foresee there?

It's a little early to ask that question. The biggest immedi-

ate benefit is that the warfare between shareholders and company will end, and that in itself will go a long way toward improving the environment.

Do you have an exit strategy, or are you in this for a long stay?

If you look at my track record, you will find that I rarely if ever make short-term investments. In this case, we envision being involved for at least 10 years.

Why should a new owner make any difference, since the previous owner at Tribune haven't found a growth strategy yet?

The management of Tribune has been significantly distracted

for the past three to four years. I am hopeful that the [new] situation will allow them and me to focus on making it bet-

How?

Stand by and watch.

The deal is highly leveraged in an industry facing structural decline. How can you make this work without massive cost cuts?

If you look at the structure we basically have in place, cash flow more than covers anticipated debt. So whereas everyone

portraying the newspaper business as dead, I think Twain's quote is applicable...that reports of its death are highly exaggerated.

This deal put you at odds with other billionaire investors like Eli Broad and Ron Burkle. How was it dealing with them?

I had almost no dealings with them.... The only involvement I have had with Eli Broad was about a week ago, when he asked me if I would be interested in taking on a partner. I said, "When I get the deal done...I'll let you know."

Are you intrigued by the prospect of taking Tribune public in the near future?

Never even crossed my mind.

Do you expect current management to stay on long-term,



PAPER CHASER
"I'm not buying trophies"

er than one year?

not a prognosticator by profession, but I'm asking current management will run this company.

How can you control a powerful media empire that produces influential papers. As we head toward the 2008 Presidential election, will you use their editorial pages to reflect your political views? Absolutely not.

This is an economic transaction. I'm not buying opinions. I'm not buying a way to get my views out there with the rest of the world. As you know from our previous interviews, I'm not averse to telling everybody exactly what I think...[but] I believe in editorial independence. I truly believe that the editorial side of this business should not be defined by someone in my position. And I'm perfectly happy to let the newsrooms continue to do what they've been doing and maybe do it better.

How would you describe yourself politically? Conservative, liberal, libertarian, or something else?

I would probably call myself an economic conservative and a political liberal.

There is so much talk about the Internet eating away at newspapers.

"I have no intention of selling the L.A. Times. Period. End of speech."

You come into this with little media experience.

That's my greatest asset, because I don't come in believing in current wisdom, and, therefore, I can look at the challenge as a completely empty canvas. That puts me in a unique position.

A lot of people talk about you being so different than the staid businessperson in newspapers, with your motorcycle and your great iconic holiday gifts. How does that make you feel?

Fine. I'd be even happier if nobody had an opinion at all and they just left me alone. I mean, this is not a dress rehearsal. I have only one life to lead.

And I have to allocate my time to do what I like. And in my private time, I like doing a lot of stuff, and I just do it. And maybe it's not the same as everybody else, but that's O.K.

When are you expecting to sell the Chicago Cubs, and does that upset you to have to sell the team?

The plans are that after the baseball season, Tribune Co. would look to make a transaction. I'm really not a baseball fan, and frankly it was a decision that management was working on long before I got involved, and it was a prudent one. There are an awful lot of people out there who would really like to own the Cubs and who would pay a lot for them. I could accommodate them. ■

Maria Bartiromo is the anchor of CNBC's Closing Bell.

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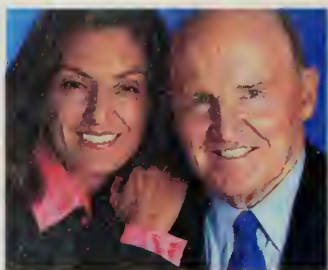
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Ideas **The Welch Way**

BY JACK AND SUZY WELCH

The New Brain Drain

Do the “best and brightest” actually lead American business?
—Bruce Frohman, Modesto, Calif.

It depends on what you mean by business. If your definition includes hedge funds, private equity, and investment banking, then the answer is a flat yes. If by business, you’re referring to the industrial and consumer companies at the core of our economy, the answer is: less and less so. And therein lies a problem.

O.K., so maybe it’s not a big problem yet, but there is definitely a worrisome trend emerging as a growing number of talented senior executives leave publicly traded businesses for privately held concerns. Dave Calhoun’s departure from GE to run Nielsen and Mark Frissora’s leap from Tenneco to Hertz are just two of the more publicized cases. But as a seasoned executive-search consultant we know recently put it: “The shift is real, and it’s gaining momentum. You can almost feel a landslide coming.”

And not only in the upper echelons—it’s happening in middle management and at business schools as well. True, investment banking has long drawn 10% to 20% of the graduates at most highly regarded MBA programs. But today an increasing number of MBAs, particularly those in the top tier of their classes, are answering the siren song of private equity and hedge funds. In 2006 almost 25% of Harvard Business School grads took jobs in those two industries. At Dartmouth’s Tuck School, 10% did—but only because the supply of private equity and hedge fund jobs wasn’t higher.

ONE REASON, OF COURSE, IS MONEY. Compensation for senior managers in public companies doesn’t compare with the heaps routinely handed out by private equity and financial firms. And it would be very hard to name an industrial or consumer company where an MBA could start by earning \$289,000 in base and bonus, the average HBS graduate’s take-home pay in private equity last year.

But we’d make the case that this trend is not totally about pay. There’s a sociological phenomenon at work here. It’s about people who love business wanting to get out of the crosshairs of people who despise it, or at least seriously distrust it. Everyone knows that American companies are being maligned these days. So-called shareholder activists have put the vast majority of corporate boards on the defensive, draining their attention away from growth initiatives, mergers and acquisitions, globalization, or

anything even vaguely risky that involves building for the future. Meanwhile, CEOs face persistent scrutiny in a guilt-until-proven-innocent media environment. So when private equity firms or hedge funds call, what business enthusiasts young or old, wouldn’t consider answering? Who wouldn’t want to do business with the kind of “cover” those outfits offer? The same goes for investment banking. Yes, most of the big investment banks are now public, but for some reason perhaps because the industry has long been known for gargantuan bonuses—its compensation levels do not generate routine shock and awe.

Now make no mistake. We’re not endorsing this nascent trend. We’re only saying we get it, and we fear it. Because “regular” American business needs the best and brightest in order to thrive in the global marketplace. We can’t have

all the big brains flocking to corners of the economy. We need them front and center.

Moreover, we need them there in 30 years. Hedge funds, private equity, and investment banking are not like consulting, where talented managers and MBAs often spend three- or four-year stints before returning to industry, wiser and richer. No, once people enter the Brave New World we’re talking about, few will leave. The money will be too good, and the ability to do business without widespread scorn too gratifying.

What can be done? The solution can only come with boards, which must pull themselves out of bunker mode to address this problem before it’s too far gone. Even in the current environment

they have to work up the courage to create compensation packages that link outsize pay to outsize performance—make sure those packages reach well below the top five executives who generate all the media and activist hue and cry. Moreover, boards must remember that for the best and brightest, the biggest career turn-on is not money. It’s important. Companies need to be offering exciting, challenging jobs with real decision-making authority to senior executives. MBAs alike.

Of course, those two measures won’t halt the flow of great people away from industry, but they could slow it to a trickle. And since great people are the whole game, that’s a dam worth building. ■

Jack and Suzy Welch look forward to answering your questions about business, company, or career challenges. Please e-mail them at thewelchway@businessweek.com. For their weekly podcast go to www.businessweek.com/search/podcasting.htm.

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The vulnerability of your business

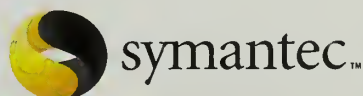
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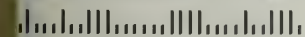
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Wal-Mart's Midlife Crisis

Down in the Mouth over Slowing Growth, Dimming Prospects

by
ANTHONY BIANCO
(PAGE 46)

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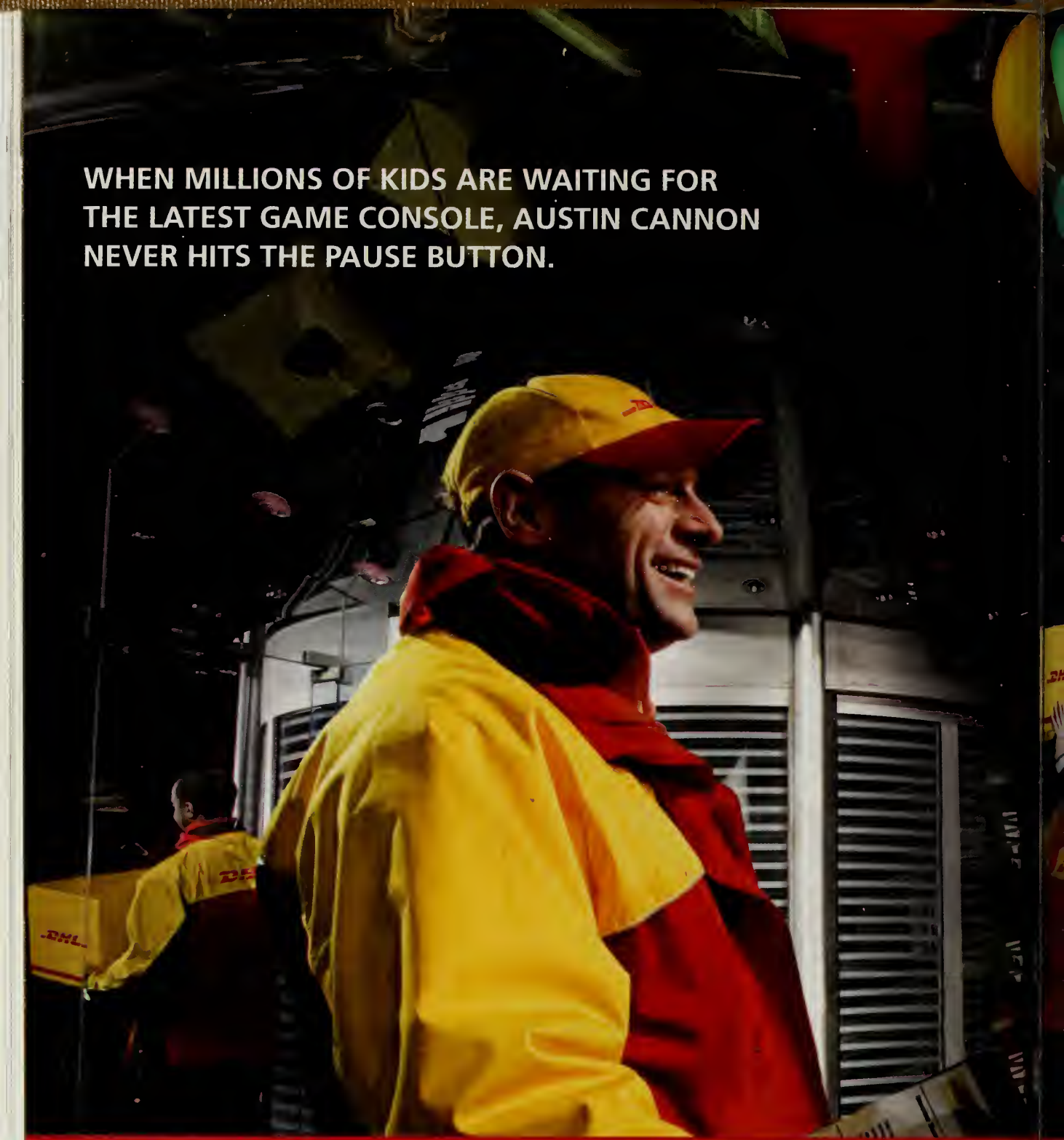
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Queen of the
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- ☐ Take a train ride on the Orient Express
- ☐ Go to the Galapagos Islands
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- ☐ Help dig for dinosaur bones
- ☐ Float along the Nile
- ☐ Own a col of Fiddle Diers
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- ☐ Climb Mount Olympus
- ☐ Watch the Sumo Wrestling Championship in Japan
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Cover Story

46 Wal-Mart's Midlife Crisis If you build it—and pile it high with everyday low prices—they will come. That formula took Wal-Mart from Ozarks upstart to preeminent American retailer. But sales growth is stalling as rivals grab share, while Wal-Mart keeps building. Add lawsuits, PR problems, rising costs, and a disenchanted Wall Street, and the picture isn't pretty



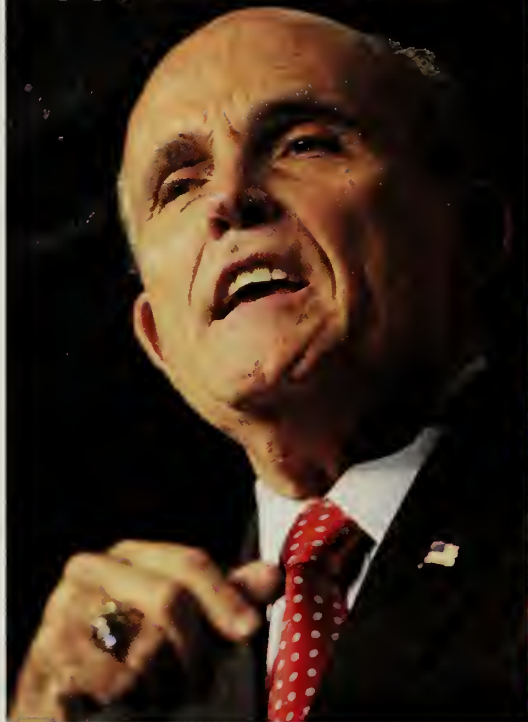
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BusinessWeek (ISSN 0007-7135) Issue number 4032, published except for one week in January, July and August, by The McGraw-Hill Companies, Inc. Executive, Editorial, Circulation, and Advertising Offices: 1221 Avenue of the Americas, New York, N.Y. 10020. Periodicals postage paid at New York, N.Y. and at additional mailing offices. Canada Post Publication Mail Agreement Number 9001. Return undeliverable Canadian addresses to: DPGM Ltd., 74 Bath Road, Mississauga, ON L4T 1L2. Email: bwkcustserv@mcgraw-hill.com
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Surviving the Startup Years:

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JP Front

"Ah, Viacom. You're either doing a business deal with them or being sued by them."

—Google CEO Eric Schmidt addressing the National Association of Broadcasters convention on Apr. 16 about the \$1 billion copyright infringement suit filed by Viacom against Google in March.

EDITED BY DEBORAH STEAD

EDGE TRIMMING

Second Curve's Vipe-Out Quarter

PAST YEAR, Thomas Brown's **Second Curve Capital** hedge fund was a standout performer. One of its three investment portfolios posted an eye-popping 68% gain, and together the value of its holdings soared to \$734 million, up 78%. But now Second Curve is getting swamped by the wave of troubles in the market in which Brown, a former Wall Street analyst, claims expertise: investing. Second Curve made a big bet on lenders that grant loans to borrowers with shaky credit histories, and on a student loan processor—one that stands to lose big in the **Sallie Mae** buyout. The hedge fund's heavy wager on the subprime market and on other financial stocks put the fund down about 30% as of Mar. 31, say people familiar with the New York-based fund. Then, on Apr. 16, the shares of the college loan servicer **First Marblehead**—Second Curve's second-largest holding—got pummeled, falling 23%. Investors pounded the Boston-based college loan processor on news that **JPMorgan Chase** and **Bank of America** were taking part in a \$25 billion buyout of Sallie Mae, the nation's largest student lender. (First Marblehead's stock has bounced back a bit since then.) Chase and Bank of America are customers of First Marblehead, and some on the Street fear that it could lose business if the buyout is completed. The next two weeks could be pivotal for Second Curve, which permits investors to redeem their money every six months. Those investors have until Apr. 30 to say whether they will do so when the second quarter ends June 30. So far, Brown says, he hasn't gotten any redemption requests. The hedge fund manager, also known for his influential **bankstocks.com** website, is confident his investors will stand behind him. He claims his 11-year-old fund has weathered two other similarly disappointing quarters in the past without incurring mass defections. "People know our performance is down," he says. "We have partners who look to give us more money when

Second Curve bet on subprime lenders and college loans. Bad moves

—Matt Goldstein



VERBATIM

FCC CHAIRMAN Kevin Martin, spoofing critics' perceptions that the agency has been too friendly to phone companies at the expense of cable, as part of a comic routine at the Federal Communications Bar Assn.'s chairman's dinner on Apr. 9:



Hi, you've reached the FCC. If this is AT&T, please press 1 for our merger-approval hotline. If you're calling from a Vonage phone, please hang up and dial from a Verizon phone. If this is the cable industry and you're calling about a waiver, your call is very important to us. [Extended pause.] Goodbye."



BOOK LAUNCH
Taubman with
Marron, Trump,
and Kissinger

EX LIBRIS FROM SLAMMER BACK TO GLAMOUR

SHOPPING MALL magnate and onetime Sotheby's owner Alfred Taubman, 83, may be a convicted felon, but he's continuing to insist on his innocence in his just-out autobiography, *Threshold Resistance: The Extraordinary Career of a Luxury Retailing Pioneer* (Collins, \$24.95). Writing on his business triumphs, Taubman is heavy on the boilerplate. But he gives a juicy personal account of the Sotheby's-Christie's price-fixing scandal that sent him to the slammer.

Taubman argues he was framed by Sotheby's ex-CEO Diana "Dede" Brooks (who pleaded guilty and did six months' house arrest) and former Christie's London honcho Christopher Davidge (who was granted immunity) after the pair cut deals with prosecutors. Taubman wound up behind bars.

In an interview with *BusinessWeek*, Taubman scoffs at the notion that Dede Brooks fixed prices on his instructions. "She's not someone who ever took anybody's orders," he says. "I don't think she ever did anything I asked her to do." Neither Brooks nor Davidge could be reached for comment.

In the book, former Inmate 50444-054 also offers entertaining glimpses of his 9½-month stay at a federal prison in Minnesota during 2002-03. His cellmate, who was convicted of drug dealing, wanted the billionaire to adopt him, regularly waking Taubman in the wee hours to press his case. Why write the book? "For my friends and nine grandkids," he says. "The younger grandkids never knew why Pops went away, and I want them to know." If a star-studded book party at New York's Four Seasons Hotel is any indication, Taubman's social life hasn't suffered much: The 400 attendees included Lightyear Capital's Donald Marron, Donald Trump, and Henry Kissinger. "I don't think they all showed up just to get a free copy of the book," he says.

—Thane Peterson

PHONE HOME GETTING IN ON THE WIRELESS ACT

FEEL THE URGE to start your own mobile network? Probably not. But Sonopia, a Silicon Valley startup, has just launched a business that allows organizations or groups of friends to become virtual carriers with just a few clicks. Even before the service went live on Apr. 2, more than 700 groups had signed up. "It's the democratization of mobile communications,"

says Sonopia CEO Juha Christensen, who once ran Microsoft's mobile-phone software unit. Nonprofits, hiking clubs, even families can set up their carrier group at the Sonopia Web site (sonopia.com).

The plan delivers a rebate to the group of 5% of monthly subscription fees. Sonopia sets the rates, which are comparable to those of major mobile carriers, keeping costs low by employing low-cost techies



in Ukraine and buying capacity wholesale from Verizon. (Users need phones that work with Verizon.)

"I love it as a model," says David

Chamberlain, the principal wireless analyst at consultant In-Stat. "Big companies have a hard time addressing very small niches, and that's what this is." And Verizon, he says, can now get to people "who are not yet using mobile." —Steve Hamm

FLACK ATTACK

THINK BEFORE YOU TWITTER

PUBLIC RELATIONS giant Edelman just got a crash course on the perils of instant communication. On Apr. 13, Senior Vice-President Steve Rubel was sending his musings out to the world through the online service Twitter, which lets users instantly post to cell phones and Web sites (BW—Apr. 2



In his post, Rubel quipped that his free copies of *PC Magazine* go "in the trash." Oops. *PC* Editor-in-Chief Jim Louderback shot back a response via the PR site Strumpette, noting that one of Edelman's "top execs had stated, in a public forum, that my magazine (and by extension, my audience) was useless to him." He vowed to cancel the free subscription, writing that "the future...I'll probably be somewhat less inclined to take a meeting with one of Edelman's clients." What did Rubel have to say about that? "Louderback taught me an incredibly valuable lesson," he told *BusinessWeek*. "I think he's a hero." The editor has accepted his apology, he says, "and we're going to meet for a nice drink next week."

—Diane Bra

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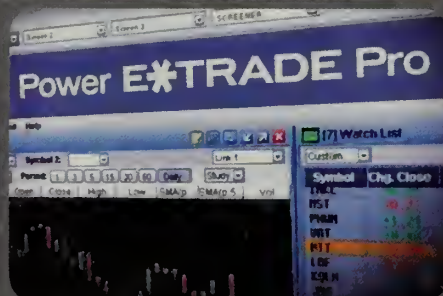


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MEDIA WATCH

ASIAN AMERICAN ROCKERS, HELP IS ON THE WAY

DO ASIAN AMERICANS want their MTV? The question has intrigued media companies as the group's population figures have soared, clocking in at 14.4 million at last count, in July, 2005. MTV Networks got in the game that summer, eventually launching three channels: **MTV Chi** for Chinese Americans, **MTV Desi** for Indian Americans, and **MTV K** for Korean Americans.

But MTV is pulling the plug on all three at the end of April, citing the challenges of its distribution model, which gives viewers access only through a monthly

of channels, you weren't motivated to do so." MTV says it's "discussing ways to continue to serve our Asian American audience."

Now the U.S. arm of **ABS-CBN**, the Philippines' largest broadcaster, is taking its turn—with **MYX**. Just launched, it's available through satellite-TV provider **DirectTV** in major cities nationwide: \$25.99 a month for a package of Philippine channels and \$4.99

à la carte. MYX hopes to reach 15-to-24-year-olds with Asian American VJs and a playlist that mixes American artists with Chinese, Japanese, Korean, and Philippine fare.

Executives in Redwood City, Calif., are betting that the content will attract a broader audience than MTV World's segmented channels did. And parent **ABS-CBN**, which has run a popular Philippine channel in the U.S. since 1994, has built-in subscribers and an insider's understanding of the market, they say. Asian community ties helped MYX sign up Asian American artists like Black Eyed Peas member apl.de.ap to promote the channel.

All this may not be enough to lure Asian American millennials, a particularly wired group, to subscription TV. "The Internet is their native ground," says Iconoculture's Yang. "The biggest competition may be YouTube." —Elizabeth Woyke

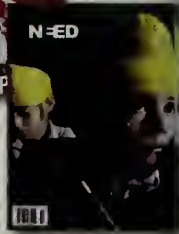


subscription to an ethnic channel package costing a hefty \$29 or so. "MTV had a huge advantage with its brand," says Jeff Yang, an Asian American consumer strategist for market researcher **Iconoculture**. "But if you weren't already subscribing to these bundles

MY MYX
Pulling in 15-to-24s nationwide

Doing Write

U.S. FOUNDATION grantmaking reached \$40.7 billion last year, and a spate of new charity magazines, all with urge one-word titles, have cropped up. (**AWARE**, described by its publisher as "Martha Stewart Giving," comes out this month after a 2006 debut as *Generosity*.) "We're seeing tens of thousands of donors looking for tools to help them do their grantmaking effectively," says Steven Lawrence, senior research director at the Foundation Center. Industry watchers point to a similar jump in philanthropy titles during the dot-com boom. None, they say, survived the bust. Here, some of the latest hopefuls. —Jessi Hempel



BENEFIT bimonthly

\$19.95/year
\$4.95/issue

Subscribers
50,000
(Bay Area)

►Photos of philanthropic fashionistas, events listings

CONTRIBUTE bimonthly

\$85/year

Subscribers
146

►A balance of charity-gala coverage and some serious policy articles.

GOOD bimonthly

\$20/year*
\$4.95/issue

Subscribers
17,500

►Lefty politics, pop culture pieces, profiles of do-gooders

NEED quarterly

\$27/year
\$9/issue

Subscribers
1,000

►Glossy, rich photo spreads to illustrate humanitarian crises

*Donated to charity

Data: BusinessWeek, mag

BLOGSPOTTING ORGANIZATION MEN

<http://discussionleader.hbsp.com/watkins/>

►IN HIS NEW BLOG for Harvard Business School Publishing, management guru Michael Watkins says he grapples with the problems leaders have dealt with "since the birth of human organization." In a recent post, Watkins, a co-founder of leadership consultant Genesis Advisers, helps readers figure out if they're "pyromaniac executives," managers with "impulse-control issues, who start the fires that waste so much precious time." Most of the blog's recommended articles are books have been written or co-authored by Watkins himself. Consider this site a fairly meaty free preview. —Lindsey Ger

IT TAKES 36 MUSCLES TO FROWN. BUT ONLY YOUR RIGHT FOOT TO SMILE.

What if the key to happiness was the same key that started your car? Well then, chances are you're driving the race-inspired 2007 Camry Sport Edition.

Race-inspired Camry? No, that doesn't mean adding pinstripes to the fenders. It's engineering the car as if you were going to run laps as well as errands.

Take the available 3.5-liter V6 powerplant.

To maximize engine performance, we improved the shape of the intake manifold and enlarged the valve

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The result? A Camry that generates an available, ear-to-ear-grinning 268 hp.

To smoothly deliver all this newfound power, we developed the Camry's available 6-speed automatic transmission.² It's so well-conceived that it actually uses 30% fewer parts than the previous 5-speed automatic

transmission. And fewer parts mean quicker response and greater fuel economy. Yes, for once, less really is more.

But if brisk performance is not enough to get the good times rolling, the Camry is filled with amenities

designed to turn your frown, well...upside down.

Like an available JBL® 8-speaker audio system with satellite radio capability³ and

MP3 compatibility. Derived from the latest in psychoacoustics, it'll quickly put you in the mood.

Or discover your own happy trails with the available

voice-activated DVD navigation system.

It features Bluetooth^{®4} technology for hands-free cell phone usage. To further

keep the gray skies away, you'll find

standard safety features, such as front and rear crumple zones and seven

airbags. For more on the car that makes

the pursuit of happiness a pedal-

to-the-metal endeavor, visit

toyota.com. The Camry SE.

When a car becomes more.



With 268 hp, you'd better get a good grip of the leather-wrapped steering wheel.



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2007 CAR OF THE YEAR™



FISCAL FITNESS

How Working Moms Chip In Twice

ARE WORKING MOTHERS a secret economic weapon? A research report from **Goldman Sachs** argues that countries where women both work and raise children are best prepared to cope with the looming global pension crisis.

According to the Apr. 3 paper, when women have careers and children, they are doubly contributing to their nation's pension system—fattening today's retirement coffers with tax payments and bearing the next generation of workers, who'll carry tomorrow's pensioners.

The report, by London-based Goldman economist Kevin Daly, concludes that developed countries don't have to choose between babies and women in the workforce. In fact, in countries where women have the most babies, they also come closest to men in their rate of employment. Daly attributes this to cultural norms and government policies that make it

possible for women to have both families and careers. Among the developed countries in the study, Scandinavia ranked highest in working motherhood, while Europe's Mediterranean countries came in last.

American women resemble their Scandinavian sisters, although they work a bit less and procreate more. Women in the U.S. have the highest fertility rate of any major developed country, with 2.05 children each. They trail U.S. men by about 12 percentage points in employment rates. (Swedish women, by comparison, have just a five-percentage-point gender gap with men.)

Women in Japan, a nation with one of the least favorable pension outlooks, work less and have fewer children. Japan's fertility rate is 1.27, according to **U.N.** estimates. The country also has a male-female employment gap of

THE BABY CROP

TOTAL FERTILITY RATE, 2005-10
CHILDREN PER WOMAN

U.S.	2.05
SWEDEN	1.80
ITALY	1.38
JAPAN	1.27

Data: U.N. estimates of lifetime total for women age 15-50

roughly 23 percentage points.

Although it's not as bad, the job gap in the U.S. could be narrowed, Daly says, by ending tax discrimination against second earners and by subsidizing child care. Daly says Goldman Sachs isn't taking sides over whether women should work or raise families. "We simply argue that couples should have the freedom to choose [what] suits them. And surveys [in developed countries] suggest more couples want both partners to be in the employment than is the case currently."

Cornell University labor economist Francine Blau says the Goldman Sachs paper adds a fresh argument to the case for policies that support working mothers. "I'm surprised that more attention has not focused on these types of issues in considering the future of Social Security," she says.

—Peter

QUESTION OF THE WEEK

Take Our Daughters and Sons to Work Day is coming up. Are there surprises in store when kids come to work?

I used to take my kids with me to visit home sites on the weekend. One time my son stepped on a two-by-four with a nail in it. He lifted his foot up, and the two-by-four was stuck to it. It was his birthday, and he said, "Dad, this birthday sucks." They both work in computers now.

—Jeffrey Mezger, CEO, KB Home

We normally have a pizza lunch on take-your-kids-to-work day, and they get to ask the chief executive any questions they want. Once, when I was CEO, one of them raised his hand and asked me why I didn't pay his daddy more money.

—Joseph Clayton, chairman and former CEO, Sirius Satellite Radio



I GOT YOU BABE
One fix pension troubles



This is a clogged artery. Health care has a way of burying itself in paperwork, which cuts productivity and wastes time. Time that isn't spent on your business. That's why we created Employer eServices® – a website that enables administrators to take care of enrollment, billing, even payment – fast and easy. It will not only save you money, it'll save your sanity. Simpler process, smarter solutions, better results for you.

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“Google should develop a business model [like] iTunes’: Charge...for selected quotes and a reduced price for the entire book.”

—John Tuccio
Monroe, Conn.



GOOGLE SHOULD TAKE A PAGE FROM iTUNES

“WHO’S AFRAID of Google?” (Cover Story, Apr. 9) contains the question: “Why would people buy a whole book when all they need is a few paragraphs?”

This is an interesting question since that business model has existed for years. It is called the library. Within a 15-mile radius of my home, I have five university libraries and numerous public libraries. When I need to do research, I use the universities’ Web sites to search the libraries, and I drive to the one with the books I need. All Google is doing is providing the same service without the cost of travel.

However, the library did buy the book, so maybe Google should develop a business model similar to Apple’s iTunes’: Charge a fee for selected quotes and a reduced price for the entire book. Many researchers would pay a nominal fee if the quote was also returned with the proper reference formatting. Google could also charge a higher fee for copyrighted extracts of paragraphs and pages. I would balance my cost of travel to the library against such fees.

—John Tuccio
Monroe, Conn.

AT STARBUCKS, CHARISMA—BUT NO MUGS

YOUR PHOTOGRAPH of Starbucks Chairman Howard Schultz with a coffee mug in “Saving Starbucks’ soul” (Marketing, Apr. 9) captures the very thing that is wrong with Starbucks: You cannot drink coffee out of a ceramic mug at Starbucks unless you bring the mug with yourself. Show me another “authentic” coffee shop anywhere in the world that serves an espresso in a paper cup. That isn’t one. The mug in this picture is probably empty, just like the soul of the coffee shop I used to love.

—Ryan Hall
Long Beach, Cal.

IF HOWARD SCHULTZ wants to triple sales in five years, Howard Schultz will triple sales. As an MBA student, I have studied Starbucks in case after case and yes, even I have been swept up by Schultz’s charismatic aura. When he joined the board of directors of DreamWorks Animation SKG, I knew his entrepreneurial spirit would increase the growth of yet another company. And when Starbucks returns to its roots, Schultz will once again prove he is

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BusinessWeek

APRIL 30, 2007 (ISSN 0007-7135)

T 4032

Published weekly, except for one week in January, July and August by The McGraw-Hill Companies, Inc. **FOUNDER:** James H. McGraw (1860-1948).
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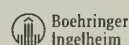
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IMPORTANT PATIENT INFORMATION

What is FLOMAX?

FLOMAX is a prescription medication that is specifically designed to help relieve the signs and symptoms of *benign prostatic hyperplasia (BPH)*, a condition your physician may refer to as an enlarged prostate. FLOMAX works by relaxing the prostate muscles around the urethra, allowing urine to flow more freely out of the bladder. FLOMAX is NOT indicated for the treatment of high blood pressure.

Who should not use FLOMAX?

You should not take FLOMAX if you are allergic to tamsulosin hydrochloride or any other component of FLOMAX.

What should I be aware of before taking FLOMAX?

- o An enlarged prostate (BPH) and cancer of the prostate cause many of the same symptoms. It is important that you see your doctor first to rule out prostate cancer.
- o Though extremely rare, FLOMAX and other drugs in this class (alpha-1 blockers) have been associated with prolonged painful erection (priapism), which is unrelieved by sex. If this occurs, seek immediate medical attention, since this condition can lead to permanent inability to have an erection, if left untreated.
- o During cataract surgery, a condition known as intraoperative floppy iris syndrome (IFIS) has been observed in patients treated with drugs in this class. When considering cataract surgery, inform your surgeon if you are taking or have taken FLOMAX and/or other drugs in this class.
- o If you have had a serious reaction to sulfa, be sure to tell your doctor before taking FLOMAX.
- o FLOMAX should NOT be used in combination with other drugs in its class since interactions may be expected.
- o FLOMAX should be used with caution in combination with cimetidine or with warfarin (a drug often prescribed under the brand name Coumadin[®] [Bristol-Myers Squibb Company]).

Are there any warnings associated with the use of FLOMAX?

FLOMAX may cause a sudden drop in blood pressure, especially following the first dose or when changing doses. Although rare, this drop in blood pressure may be associated with fainting, lightheadedness or dizziness. Caution should be

exercised when driving, operating machinery, or performing hazardous tasks, since injury could result.

What are the most common side effects of FLOMAX?

The most common side effects are dizziness, runny nose, and a decrease in semen. Other side effects include headache and tiredness.

How should I take FLOMAX?

FLOMAX 0.4 mg capsules are taken once daily. FLOMAX should be taken approximately one-half hour after the same meal each day. If you stop or forget to take FLOMAX for several days, start again with the 0.4 mg once-daily dose. If you were previously on a higher dose, contact your doctor before returning to the higher dose.

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What about overdosing with FLOMAX?

You should always take your medications according to the directions given by your doctor. If you think you have taken an overdose of FLOMAX capsules, contact your doctor immediately.

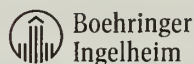
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FL-BSC(03/06)

er, not only in his industry but in American business as a whole.

—Michael Aaron Gallagher
Syracuse, N.Y.

FOLLY OF BUYING A HOME WITHOUT LEGAL ADVICE

LETTER "Subprime loans: Real estate lawyers need to speak up" (Readers Report, Apr. 9) responded to the *BusinessWeek* articles "Who will get shredded?" "Under the Fed's hammer" (News Insights, Mar. 19), by asking where the lawyers' lawyers were. The answer is simple and obvious. In virtually all cases, the lawyer wasn't there because no offer was retained.

Most people get into trouble because they see hiring a lawyer as a luxury, not a necessity. For minor matters, that's likely true. However, when it comes to major matters, such thinking is foolhardy.

As a lawyer, I find myself constantly asked to explain to errant clients why it is important to hire a lawyer to provide objective, educated, and dispassionate advice when they are confronted with the need to make a critically important decision. Indeed, it would be better to engage the reasonably priced legal counsel (if not regular attorney is too pricey) than to gamble without the benefit of legal advice. It is comparable to gambling in Las Vegas without knowing the odds, or even how the games of chance are played.

—John J. McGowan Jr.
Cleveland

CONTINUING NOBIA OF HOLLYWOOD

PHEN H. WILDSTROM is stunningly correct in "Now playing: Digital disarray" (Tech&You, Apr. 9), about the madness of Hollywood and downloads. But he didn't point out that history is simply repeating itself, albeit with a new generation of barbarians. In the 1950s, the same studios did everything in their power to prevent films from ever being shown on television. As a result, the midnight movies grew up with were all British, and half bad, either. What the studio's policy did was drive the networks to produce original content, and then cable, and now movies are all over the dial. Well done, Hollywood.

So I will wait. All the studios are doing with their myriad restrictions on my purchases is to prove to me there is nothing I really have to have. And they're right.

—David Wineberg
New York

CORRECTIONS & CLARIFICATIONS

"The greening of America's campuses" (Environment, Apr. 9) gave the wrong location for the University of Tennessee. It is Knoxville.

GE LEADERS NEED A PERFORMANCE EVALUATION

IN "SECRETS OF AN HR superstar" (Managing, Apr. 9), General Electric's former head of human resources, William J. Conaty, is quoted on GE's employee performance-rating system: "We want to create angst in the system.... We have evolved from being anal about what percent have to fall into each category. But you have to know who are the least effective people on your team—and then you have to do something about them."

GE's stock price fell off a cliff in 2001 and is still staggering about. That should create angst and speaks to system effectiveness, the mythology of executive superstars, and performance systems that seem to apply to everyone except those superstars.

CEOs come and go, but what matters are the GE workers who come to work each day and take pride in their work. Ultimately their performance is reflected, for example, in the jet engines they build that get airline passengers safely to their destinations. I'd rather have them concerned about the safety of those engines than about what is taught at Crotonville.

—Bill Jenkins
Corvallis, Ore.

WHILE IT SEEMS like GE has been a leader in human resources in many areas, its reliance on fear as a motivating factor is so last century.

Truly progressive companies have moved beyond that to the recognition that building core collaborative relationships is now the key to corporate success.

—Robert E. Anderson
Allendale, N.J.

IN DEFENSE OF THE 'AVERAGE' EMPLOYEE

IS NAIVETE, or worse, revealed when professionals like Michael Alter, president of SurePayroll, make statements like: "There are certain professions where skills are in such demand that even average or below-average people can get hired" ("Where are all the workers?" News & Insights, Apr. 9).

Can someone tell us when the time

was that "average people" were not hired? When was that golden age? Many of us missed it.

Isn't the executive manager's challenge to coach, counsel, and train "average people," the middle 50% of the range of talent in every executive corps existing now or ever, in ways that produce excellence?

Recent years prove the value of average people by what they didn't do: Average people didn't burn \$40 billion to \$60 billion at Enron; average people didn't steal billions from energy consumers; and average people aren't burning American lives, cash, and credibility in Iraq.

When American senior executive management accepts its responsibility to produce excellent results with average people, including average executives, America will arrive at a better place than it is now.

—William L. Welch
Oakland, Md.

I AM AN ELECTRICIAN with more than 30 years in the trade. As a young man I worked in construction but constantly upgraded my technical skills by taking evening college courses. I presently work in a high-tech manufacturing environment and possess a highly marketable skill set.

My comment is this: There is no shortage of opportunities available. And there are many individuals with strong technical backgrounds looking for change. The problem, in most cases, is that compensation is 20 years behind the times. It is 2007, not 1987. I would never sell my skills on the cheap. As for a lack of candidates, when you pay people peanuts, all you get is monkeys.

—Robert Protomanni
Vaughan, Ontario

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At Last, an Online Art House

According to the “long tail” theory of the Web, e-merchants can make a bundle selling low-volume products to niche markets because they don’t bear the cost of maintaining retail floor space and inventory. Amazon.com and iTunes have proven this can work with their far-flung book and music offerings. But vendors of online movies have never had a clue.

Until Jaman, that is. This startup download service aims to become an online film festival for world movies and the works of independent filmmakers—the sort that don’t have distribution deals with Miramax Film or Fox Searchlight Pictures.

The concept is more novel than you might think. Outside of Jaman, the movies available for download today are mostly a subset of the limited offerings at your local Blockbuster, dominated by films that have recently finished their theatrical runs, box-office hits of the last few years, direct-to-video flops, and just a smattering of classics. Movielink’s download service offers fewer than 150 of the thousands of movies made before 1970, plus a shamefully underpowered roster of 40 foreign films.

Jaman is helping to correct this imbalance. You may never have heard of many of its offerings if you aren’t an avid fan of Bollywood productions or martial arts movies. Personally, I’m not. Still, I enjoyed watching *Miracle in Cracow*, a quirky Hungarian fantasy, and *Semen*, a goofy Spanish romantic comedy about, of all things, *in vitro* fertilization.

LIKE NEARLY ALL MOVIE DOWNLOAD services, Jaman requires its own software player, which is available for both Windows and Mac OS X. The image quality is very good, both on PC displays and on the big screen I connected to my laptop. Someone at Jaman obviously cares deeply about the conversion of film to video, a process that poses both technical and artistic challenges, and has done it about as well as it can be done.

Jaman’s business model is also a step up from other services. Most Jaman offerings are available to purchase for \$4.99, much lower than the \$15-plus price of a DVD. Or you can pay \$1.99 to rent and watch for seven days, as opposed to the 24 hours most services allow. For the moment, a goodly chunk of Jaman’s library can be rented without charge.

As befits a Web startup, Jaman offers an assortment of social networking features. The player lets you enter comments to share with other viewers, tied to specific



Jaman has an eclectic catalog of easy-to-download movies

moments in the movie. As the film plays, the comments appear in a window to the side of the video display. I found it a bit distracting and preferred to watch my movie full-screen, but I can see how this would appeal to a generation used to instant messaging its way through movies in theaters. Or maybe you don’t want to watch a commercial film at all—a new feature in Jaman allows users to submit their own creations. Users can also post reviews.

Jaman isn’t the only video service trying to exploit the niche market opportunities of the Web. A service called Akimbo offers a potpourri of video, from foreign TV series to Turner Classic Movies, that can be downloaded and watched either on a Windows PC or on a TV using an RCA set-top box (\$99 after rebate). One drawback is complex pricing that includes a \$10 monthly fee, plus additional fees for much of the content. Another service, EZTakes has an eclectic variety of foreign,

independent, and cult films and a scattering of old Hollywood productions. Instead of using a player, you download the file and burn them to DVD. Prices range from \$1.99 to around \$

By definition, Jaman and other out-of-the-mainstream services aren’t to everyone’s taste. But for anyone looking to go beyond the greatest hits approach of iTunes, CinemaNow and the others, Jaman is well worth a look. ■

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Ford Models' Digital Runway

As the most casual Web surfer knows by now, the ease of showing video online has led to a deluge of video from nonmedia types everywhere, be they random YouTubers or big companies beefing up corporate Web sites. Making video into something resembling an actual business, though, is another story: Just because everyone can do it does not mean everyone can

do it well or make a buck off it. Unless, that is, a company has long been familiar with life in front of a camera and the power of image and imagery.

This year Ford Models began cranking out all manner of Web videos, and the move seems neither ill-advised nor born of abject fear. It's far too early to know if this ends up a short-lived sideline for the 60-year-old modeling agency or becomes another way to make decent money off its picturesque assets, but it's not crazy to think that this nonmedia company may figure out new ways to make Web video work.

For one thing, models require little persuading to take star turns on film. "It's really great. I am not a still-life picture," says Ford fitness model Kim Strother, who sometimes appears in workout videos with her tiny, ill-behaved Yorkshire terrier, Moose. Ford's videos range from the instructional (think workout and styling tips) to the semi-informational (the breathless, trendspotting 30-second *Fashion Flash*). Also the frankly voyeuristic: *Changing Room Confessions*, in which Ford models critique clothes they try on in department store dressing rooms, predictably draws catcalling commentary on YouTube. Production costs are low. John Caplan, Ford's president, says some vids cost as little as \$100. Production quality, as you might imagine, is high: Modeling agencies know from flattering angles and lighting.

AT TIMES FASHION'S inherent absurdity bursts right out of the footage. In one *Fashion Flash* episode, an overly excited host revealed "it's all about platinum blonde hair, so get out your bottles of bleach and hydrogen peroxide because everyone is doing it!" in tones befitting an exultant *American Idol* contestant.

Ford just launched fordmodels.tv and has partnerships



Web video may give it a new way to capitalize on its assets

with targeted community sites such as BlackPlanet.com and women's portal iVillage.com as well as with host of video sites and distributors such as YouTube and Mochila. (Ford's strategy resembles that of CBS, which in late April announced nonexclusive video deals with 10 Web sites instead of becoming an exclusive equity

STROTHER
Models get
30% of Ford's
video net

partner with NBC Universal and NBC Corp.'s nascent, still-unnamed video sharing service.)

Ford has cut ad-sharing deals with Web partners, and the models in the videos get around 30% of Ford's net. The agency does not have an ad sales team, which may limit the dollars it can cadge from the videos. But it has something potentially better: long-standing relationships with practically every biggie in beauty, fashion, and retail, some of which are discussing the possibility of sponsorship or placing brands in Ford's videos. As you might expect from a model-mad culture, many parties are interested. "We are targeting twentysomethings who want to be cool," says Pamela Seidman, a spokeswoman at retailer Express, which is in talks with Ford. "They want to be a celebrity. They want to be a model.... It's kind of a no-brainer for us."

Everyone wants to be next to a model. But models—or at least their reps—are more careful about the venues they frequent. Ford remains fully in control of its image; that wouldn't have happened had the agency gone whole-hog into reality TV with a production partner. ("We are purposefully uninvolved in shows like *America's Next Top Model*," claims Caplan.) Ford's video ventures also position it as an arbiter and authority on obvious subjects, such as hair and make-up, and less obvious ones, like health. Of course none of that would matter were it not driven by something basic. People like looking at models. Who knew? ■

BusinessWeek .com



For Jon Fine's blog on media and advertising, go to www.businessweek.com/innovate/FineOnMedia.

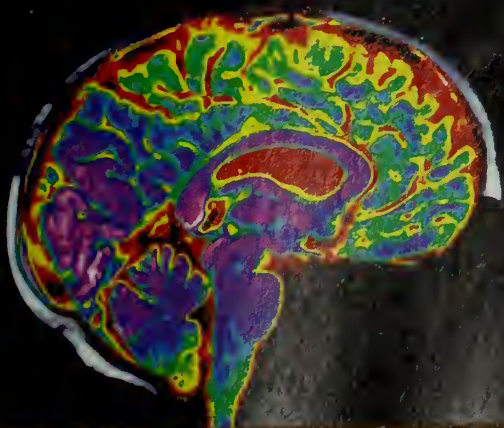
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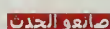
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JAMES MEHRING

As the Trade Deficit Shrinks, A Plus for Growth

weaker dollar and strong overseas demand will shrink the gap

U.S. ECONOMY The narrowing U.S. trade deficit could give a lift to economic growth in 2007 for the first time in a dozen years. Surging exports and slower growth in imports reduced foreign trade's drag on the economy to virtually zilch in 2006, and the primary factors that led to the improvement last year are still in place. Most notably, strong

global economic expansion and a softer U.S. dollar should keep exporters busy, while weaker domestic demand in the U.S. holds down the appetite for imports. Indeed, the global economy is managing quite well without the U.S. leading the charge. According to the latest semiannual economic forecast from the International Monetary Fund, world economic growth should be 4.9% this year, compared with 2.2% for the U.S. What's more, global growth should be balanced, with key U.S. trading partners such as the euro zone, Japan, and Canada expected to fare well this year (chart). The U.S. Census Bureau's February foreign-trade data show an increased risk that trade will pose a small drag on the economy in the first quarter. Adjusted for changes in import and export prices, the merchandise trade deficit widened a bit.

But the February results are no cause for alarm. Without adjusting for price changes, the trade gap narrowed to \$58.4 billion as a drop in imports, driven by lower oil prices, more than covered a one-month \$2.8 billion decline in exports. In addition, many economists are forecasting that trade will be a plus to economic growth this year also expected a slight setback in the first quarter. That isn't a shocker considering the surprising performance in the fourth quarter, when trade accounted for nearly two-thirds of the 2.5% annualized gain in real gross domestic product.

FUNDAMENTALS SUPPORT a solid rebound in exports during the coming months. For starters, a weaker dollar is providing a competitive boost. Since early 2002, the greenback has fallen nearly 30% against a trade-weighted basket of major currencies such as the euro and yen (but excluding the yuan). A declining dollar reduces the prices of goods or services in foreign-currency terms. It allows U.S. companies to gain precious market share by holding prices steady in dollar terms. Further declines in the dollar appear likely. The convergence in global and U.S. growth will probably mean that foreign central banks, particularly the European Central Bank and Bank of England, will raise interest rates while the Federal Reserve stays on hold. Diversification of

foreign reserves among developing and oil-producing nations into other currencies and assets could also exert some downward pressure on the greenback.

More important for U.S. manufacturers, however, is the continued strength in foreign capital spending. Global economic growth has been no slower than 4.9% in the past three years. This sustained level of strong economic expansion soaked up a lot of excess capacity. Many factories abroad are operating flat out. In the euro zone the capacity utilization rate climbed to 84.4% in the first quarter, the highest level since 2000. In Japan, the utilization rate hit a more-than-15-year high in December. But the limits in capacity extend beyond manufacturers, as the demand for commodities by China and other countries is straining the infrastructures of resource-rich nations such as Australia and Brazil.

The need to build new factories, expand ports, and pave more roads means increased demand for capital equipment, which is likely to be good news for U.S. makers of big ticket items such as construction equipment and other capital goods. The March industrial production data showed capital-goods makers were busier. And the

GLOBAL ECONOMY HOLDS UP AS THE U.S. COOLS

REAL GDP GROWTH		
ANNUAL PERCENT CHANGE: 2006		
	2006	2007*
BRITAIN	2.7	2.9
CANADA	2.7	2.4
CHINA	10.7	10.0
EURO ZONE	2.6	2.3
JAPAN	2.2	2.3
MEXICO	4.8	3.4
U.S.	3.3	2.2
WORLD	5.4	4.9

Data: International Monetary Fund *FORECAST

March reading on export orders by the Institute for Supply Management improved.

Expanding businesses overseas are also hiring workers, which is leading to tighter labor markets and improved domestic demand. Around the world, consumer spending is rising, helping to drive demand for U.S. consumer goods. Exports of consumer goods are on a tear, up 13.3% from a year ago in February.

WHILE THE PICTURE for exports looks good, slower import growth will ultimately determine whether the trade balance provides some support to U.S. economic

expansion. To understand why, just look at the numbers. Imports of goods and services were nearly 1½ times as large as exports in 2006. That means in order for the trade gap to narrow, exports must grow more than 50% faster than imports.

Import growth has been moving in the right direction. In the year ended in February, imports of goods, adjusted for inflation, are up only 2.6% (chart). That's down from a 8.9% growth rate in the year ended in August, 2006. The outlook for subdued growth in imports remains favorable. The housing recession and growing caution among businesses with regard to domestic investment plans should ease demand for foreign capital goods and industrial supplies.

U.S. purchases of foreign-made consumer goods are what merit the most attention now. On the surface, the March retail sales report showed continued strength in consumer spending, but a 3.1% jump in gasoline sales, due to higher pump prices, implies that consumers are experiencing a decline in purchasing power. If gas climbs above \$3 per gallon nationwide, and stays there a while, it will probably cool down imports of consumer goods.

ALTHOUGH THE STARS are currently aligned for an improving trade balance this year, risks still exist. On the export side, protectionist urges could backfire. As the Presidential election season heats up, campaign rhetoric and political pressure to level additional tariffs and duties on China will probably grow. But politicians know such actions would run the risk of retaliatory measures by Beijing just as China is growing

in importance as an export market. In 2006, exports to China grew by 31.7%, to \$55.2 billion, making it the No. 4 destination for U.S. exports.

Chances for a narrower trade deficit this year would also take a hit if the U.S. economy does better than expected. That's because imports are directly linked

the health of business investment and consumer spending. Given the trade math it wouldn't take much of an acceleration in imports to offset a strong gain in export

Right now, U.S. economic growth is widely expected to improve gradually during the course of the year as the drag from

IMPORT GROWTH SLOWS DOWN



housing diminishes. However, a quicker revival in the U.S. economy that would lead to another widening in trade gap would certainly outweigh any potential boon that trade could provide.

Even if all does go as expected this year and the trade balance narrows, making additional progress won't be easy. It will be awfully hard for exports to consistently outpace imports by the huge margin needed. But the latest signs that the global economy may be less dependent on the U.S. as the primary engine of growth does offer hope. ■

VACANCY RATES

Housing Provides Some Inflation Relief

INFLATION PRESSURES remained stubbornly high in March. But a let-up could be coming soon. Fallout from the housing recession looks set to put a lid on what have been rapidly rising rental and housing costs.

The consumer price index, less food and energy, was up 2.5% from a year ago in March. A lot of the upward pressure in core inflation has come from rents, up 4.6% on a yearly basis. Rent data are also used by the Bureau of Labor Statistics as an input to calculate homeowners' cost of shelter, referred to as "owner's equivalent rent." This price index rose 4.1% from a year ago.

But shelter costs

should settle down soon. Looking at vacancy rates and shelter costs in 24 cities used by the BLS to calculate inflation, Goldman Sachs economist Seamus Smyth found that shelter inflation eased when vacancy rates rose above the long-term average.

"These empty housing units are essentially excess supply on the market" Smyth writes in a research note to clients.

Vacancy rates are currently quite high. In the last quarter of 2006, the homeowner vacancy rate hit a record 2.7%, while the rate among rentals was 9.8%, vs. a 7.1% historical average.

Further downward pressure on rent costs is likely. According to

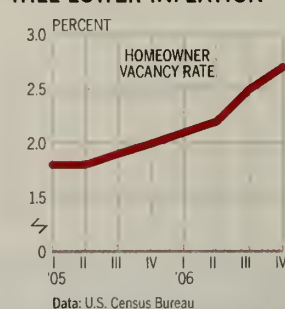
the National Association of Realtors, new multifamily homes are still being added in some saturated markets, such as Philadelphia and Atlanta. What's more, many condominiums are being converted into rental units.

As increased supply holds down rents, it will also lead to a slowdown in homeowners' shelter costs. That would have a real impact as owner's equivalent rent accounts for nearly 31% of core CPI and rents almost 10%.

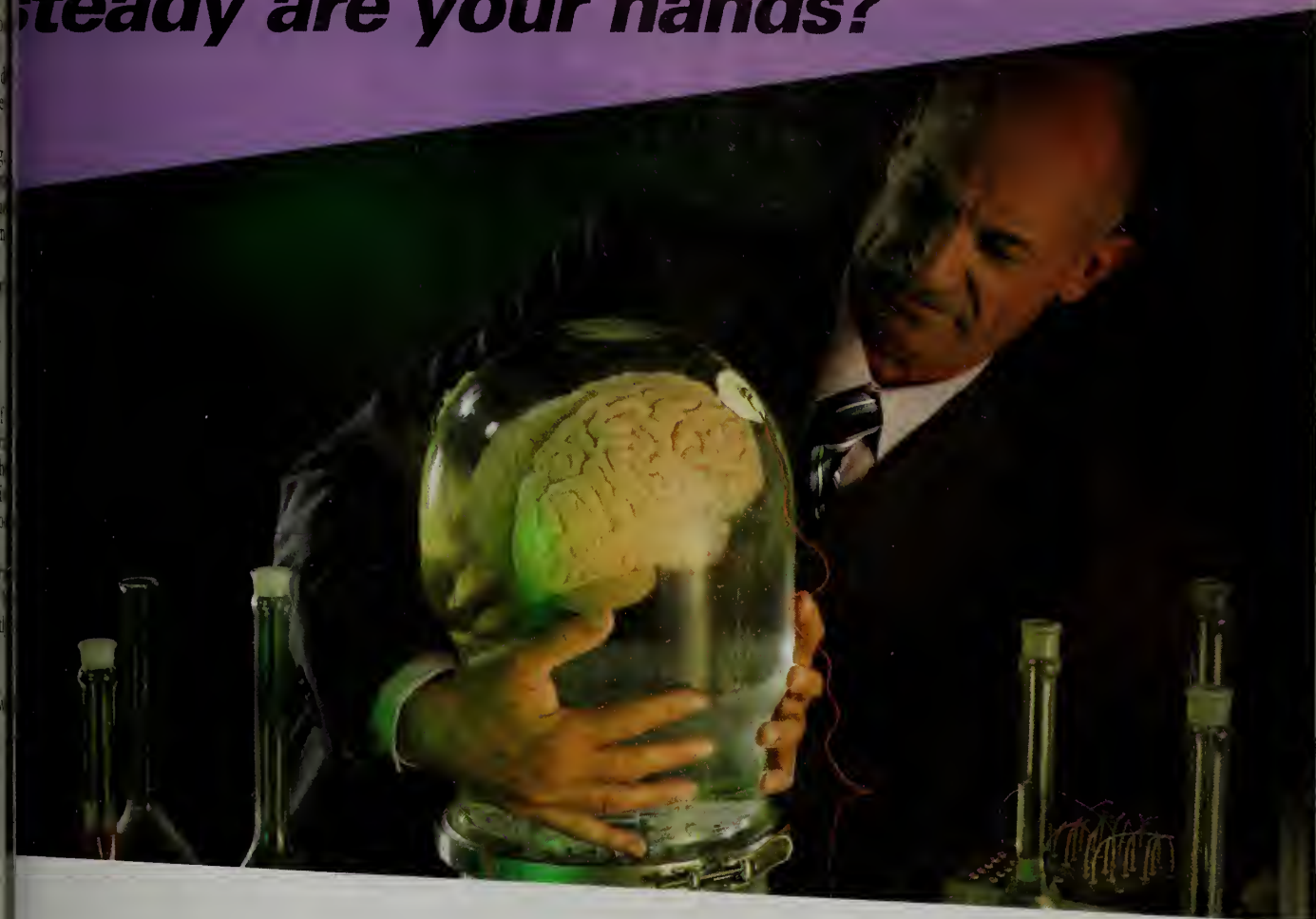
Lower shelter inflation could also play a role in monetary policy. The Federal Reserve's preferred inflation measure, the core person consumption expenditures price index, also uses owners' equivalent rent, although it is given less weight. If the economy were to weaken further, lower core inflation would remove a big hurdle to cutting interest rates. ■

—By James Meh

MORE EMPTY HOUSES WILL LOWER INFLATION



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NEWS YOU NEED TO KNOW EDITED BY HARRY MAURER



PRIVATE EQUITY NABS SALLIE

It's hard to keep up with **Sallie Mae**. Just three years ago the nation's largest student lender was a quasi-government enterprise. Now the public company is going private in a \$25 billion deal led by a consortium of two buyout firms, **J.C. Flowers** and **Friedman Fleischer & Lowe**, and two investment banks, **JPMorgan Chase** and **Bank of America**. Sallie Mae recently settled with **New York State Attorney General Andrew Cuomo** in the still-unfolding student loan investigation, pledging to stop proffering perks to college financial-aid officers.

The Sallie Mae deal, which was announced on Apr. 16, faces plenty of scrutiny from regulators. Some 85% of the company's business is guaranteed by the government. Nonetheless, Sallie's suitors are arriving at a good time. Both the Bush Administration and the Democratic-led Congress have been clamoring to cut the subsidies that have made Sallie so profitable over the years. If Sallie's federal funding or access to capital dries up, the buyers' deep pockets and \$200 billion in backup financing will help ensure it can keep making those low-cost loans.

ONLINE "Sallie Mae's suitors," www.businessweek.com/go/tbw

Online Ad Wars

Google's blitzkrieg isn't slowing down. On Apr. 13 the search king announced it will buy online ad placement firm **DoubleClick** for \$3.1 billion, giving it a chance to expand beyond search ads to online display ads. **Microsoft** and **AT&T** cried foul and said they'd push for antitrust review. On Apr. 16,

Google struck again, signing a deal with **Clear Channel** to place ads on 675 radio stations. Rivals aren't standing still: **Yahoo!** on Apr. 16 added five newspaper publishers, including **McClatchy** and **E.W. Scripps**, to an ad-revenue-sharing partnership, though a grim first-quarter earnings report on Apr. 17 renewed

speculation that **CEO Terry Semel's** job may be in jeopardy.

ONLINE "Google: The ad dominator?" and "Yahoo's next search: A new CEO?" www.businessweek.com/go/tbw

New Suitors for ABN?

London-based **Barclays** and **ABN Amro** of the Netherlands are

holding hands, but will a trio tear them apart? The two are close to an \$80 billion to \$90 billion deal that would create the world's fifth-largest bank, said a source close to ABN on Apr. 18. Meanwhile, **Royal Bank of Scotland**, Spain's **Santander**, and Belgian-Dutch **Fortis** have written to ABN requesting access to its books. Analysts say that by dividing up the bank among themselves, these three could afford to bid more than Barclays. ABN is skeptical but will likely sit down with them soon.

Inflation Watch

Flaring gasoline prices (up nearly 11%) caused inflation to heat up in March, but other prices were blessedly cool, according to figures released by the **Labor Dept.** on Apr. 17. Among the items that got cheaper in March: Fruits and vegetables, lodging, apparel, used cars and trucks, and medical-care products. Core consumer prices excluding food and energy rose just 0.1% and over the past half-year are up at an annual rate of 1.9%.

ONLINE "March CPI won't swell inflation-wary Fed," www.businessweek.com/go/tbw

BlackBerry Breakdown

"Crackberry" addicts across North America went cold turkey for several long hours late on Apr. 17-18 when **Research in Motion's** popular BlackBerry service stopped sending and receiving e-mail. RIM did not have an immediate explanation for its 8 million customers. Its shares tumbled on Apr. 18 in early trading before recovering.

Vonage in Peril

More bad signals from **Vonage**. The Internet phone outfit said on Apr. 12 that **CEO Michael Snyder** is leaving immediately

man Jeffrey Citron steps
s acting chief. Vonage
been ordered to pay \$58
ion to Verizon in a patent
ingement case, and on Apr.
n appeals court will hear
ments on whether Vonage
ld be barred from taking
ew customers. In an SEC
g on Apr. 17, the company
the litigation could land it
nkrruptcy.
NE "Sprint: Say bon voyage
onage,"
v.businessweek.com/go/tbw

Blackstone Offloads

Don't look now, but private
equity behemoth Blackstone
Group is doing plenty of selling
as well as buying. On Apr. 18
it agreed to sell its Extended
Stay Hotels to real estate owner
HouseGroup for \$8 billion.
It's the sixth company worth
\$1 billion-plus that Blackstone
has sold since February,
according to Thomson
Financial. Blackstone paid over
\$1 billion for Extended Stay
in 2004.

Monster Turnover

William Pastore, CEO of online
search giant Monster
 Worldwide, is chucking the job.
Pastore will stay on the payroll
until June to help director Sal
Auzzi take over, the company
said on Apr. 12. Pastore was

elevated to CEO from COO
just last October, taking over
when Andrew McKelvey quit
after declining to talk with
investigators looking into
possible options backdating.
No explanation was offered for
Pastore's exit.

Taking Aim at Wang

The founder did it. That's
the gist of a scathing report
written by a board committee
of Long Island software maker
CA. The report, filed in court on
Apr. 13, accuses founder and
former Chairman Charles Wang
of being partly responsible
for the misdeeds that resulted
in convictions of more than a
dozen executives for securities
violations. It said CA should
sue Wang to recover some of
his compensation. Wang, for
whom the statute of limitations
has run out, denies culpability.

Freelancing at Dow?

Dow Chemical employees
no longer wonder who was
behind rumors of a \$50 billion
private equity takeover. Dow's
board on Apr. 12 fired two
veteran executives, including
former CFO J. Pedro Reinhard,
after a source at JPMorgan
Chase said they had been
shopping the company on their
own in recent months. The two
denied doing any such thing.

PROMOTION OF THE WEEK

What will ink-stained wretches have to speculate about now?
Lapping one of the most buzzed-about succession sagas in
media, *The Wall Street Journal* said on Apr. 18 that 45-year-
old Marcus Brauchli will succeed Managing Editor Paul Steiger,
who is retiring after 16 years at the helm.
Steiger, under whose tenure the *Journal*
won 16 Pulitzer Prizes, including two on
Apr. 16, will serve as editor at large until
he retires at yearend. Brauchli takes over
key post in business journalism at a time
of upheaval as newspapers grapple with
declining readership and search for new
venues online. He faces unique challenges
as the *Journal* as well, with the newsroom
squaring off against management in
contract talks. A onetime China bureau chief, Brauchli proved
his mettle upon his return to New York as the paper's national
and then global news editor. In his most recent position as
deputy managing editor, Brauchli oversaw the *Journal*'s redesign
prior this year. He says he is dedicated to continuing to make
the *Journal* "a place where people will seek out islands of clarity
and authority" as information becomes more commoditized.



MARCUS BRAUCHLI

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CHINA

CAUTIOUS

The Chinese are on a spending spree, right? Not really. In fact, they're so tightfisted, Beijing is worried

BY DEXTER ROBERTS



CONSUMERS



DOUG KANTER/POLARIS

MEEET THE XUS. THIS typical Chinese middle-class family of three shares a two-bedroom apartment in Beijing, purchased four years ago for \$40,600. The father, 51-year-old Xu Zhibao, takes home \$454 a month from his job as a teacher at Beijing Pharmaceutical College. His wife, Zhang Xiaoping, 50, earns \$260 a month as a nurse at a local hospital. Their 25-year-old daughter, Xu Hong, is a student at People's University. A Whirlpool microwave oven and a Haier refrigerator command pride of place in the tiny kitchen. Among the family's other prized possessions are two Sony televisions and a Mitsubishi air conditioner.

But it isn't just the things the Xus have bought that make them representative of China's bourgeoisie; it's also what they choose not to buy. Like most mainlanders, the family members sock away tons of cash, close to 40% of their earnings every month. The Xus hardly ever go to restaurants, a movie outing is a rare treat, and they have no plans to trade in their bicycles for a motorcycle or car. "Only if a product is discounted heavily and I think it's worth it will I consider buying it," says daughter Xu Hong.

Isn't China in the grip of a consumer frenzy? Well, sort of. Car sales shot up 30% last year, while retailers from Wal-Mart Stores Inc. to Carrefour are doing a brisk business as newly prosperous mainlanders stock their larders and living rooms. And not a day goes by without some big-name American company announcing a new China push.

CHENGDU
Beijing aims
to boost
buying power
in the interior

On Apr. 16, for instance, Hewlett-Packard Co. unveiled an energy-efficient computer aimed at the China market.

But look beyond the

headlines and you'll find that China's 1.3 billion people are actually buying relatively little. Although the mainland's population is four times that of the U.S., Chinese consumers last year spent just 12% of what Americans did, figures investment bank UBS. And private consumption as a share of gross domestic product in China is falling, to less than 40% today from about 48% in 2000.

Prying open the wallets of tightfisted folks like the Xus is emerging as the hottest political topic in Beijing. Although the economy is still expanding at 10%-plus annually, China's economic mandarins are concerned that the country's growth depends too much on its soaring exports and investment in ever more factories and luxury high-rises. Exports leave the Middle Kingdom vulnerable to potential downturns in the U.S. and Europe while causing trade tensions with Washington. And too much investment threatens overcapacity in industries from steel to autos. So Beijing has cut taxes and boosted some social outlays to spur Chinese to spend more at the mall. "We need to adjust the balance between investment and consumption," Premier Wen Jiabao warned at the annual meeting of the National People's Congress on Mar. 5.

NOT TRICKLING DOWN

WHEN MIGHT THE Chinese consumer help really drive the global economy? Analysts at Credit Suisse Group have conjured a rosy scenario in which China becomes the world's second-largest consumer nation (after the U.S.) by 2020, up from No.5 today. UBS is less upbeat, estimating that the middle class includes only about 25 million people—just 2% of China's population—hardly big enough to have much impact globally. And even Credit Suisse acknowledges that personal incomes, while climbing, aren't keeping pace with rising GDP. "If you think the purpose of rapid economic growth is



to increase consumption and the general welfare, then China isn't doing a very good job," says Nicholas R. Lardy, senior fellow at the Peterson Institute for International Economics in Washington.

The problem is vexing not just for Beijing but also for the legions of global companies making big bets on China. With the more prosperous coastal areas already reaching saturation in everything from cellular phones to fried chicken outlets, foreign investors have to drive deeper into the interior in search of sales. "There are 900 million people in China" without mobile phones, says Michael Tatelman, president of Asia Pacific Mobile Devices at Motorola Inc. in Beijing. "We are looking at how to reach the unconnected." Getting to those people can be tough. Rural consumers "are a very dispersed crowd," says Jonathan Anderson, chief economist for Asia at UBS. To address that, the Commerce Ministry is working on a project—likely to include Procter & Gamble Co.—that would seed the Chinese countryside with small retail outlets.

China used to approve foreign-owned factories only if most of the output would be exported. More recently, though, Beijing has shifted the emphasis to consumer goods for sale within China. Sony Corp., for instance, once sold the bulk of its Chinese production abroad, but today it's devoting more resources to developing televisions, MP3 players, and other gadgets specifically for sale to Chinese consumers.

Ultimately, if Beijing wants to unlock consumer spending, it must do more to make ordinary Chinese feel secure about the future. With the market reforms of the

past three decades, the safety net of lifetime housing, free education, subsidized health care, and a pension—all courtesy of the state—has been largely dismantled. As a result, Chinese "want to save every penny," says Chen Zhiwu, a professor of finance at the Yale School of Management. "In case of sickness, job loss, an auto accident, or old age, they will have some way to support themselves."

A BREAK FOR FARMERS

The Xus would agree. "Our money is limited," says father Xu Zhibao. These days he pays \$270 a month for his mortgage, something he didn't have to worry about when the family lived in an apartment provided free of charge by his father's employer, a printing factory. And throughout much of the past decade, falling food prices meant that city dwellers such as the Xus could easily afford eggs, meat, and other staples. Now they face rising food prices, which increased by 2.3% last year. This year, inflation for the first quarter alone probably jumped an additional 3%, largely because of a surge in the cost of food, estimates Merrill Lynch & Co.

To ease the burden, the government has been pumping more money into social initiatives. The national budget for education is slated to rise by 42% this year, while outlays for public health will nearly double—though government spending

as a share of GDP continues to decline. Beijing also earmarked \$3 billion for employment and worker-retraining programs. At the same time, in several provinces government is trying out a new hybrid public-private pension system.

Beijing has also been tinkering with taxes. Last year, in a move aimed at kick-starting consumption, it doubled the income threshold at which citizens start getting taxed, to about \$200 a month. And after years of being trampled on the road to progress, China's farmers are getting a break. Last year, Beijing allocated a 2,000-year-old agricultural tax and handed out billions of dollars in subsidies to grain farmers and schools. To stimulate the creation of jobs in rural areas, and thus boost spending there, Chinese legislators in March left intact tax breaks for foreign companies that are investing in forestry, farming, and fisheries even as they did away with incentives in most other areas.

THE XUS

Like most middle-class families in China, they're frugal shoppers

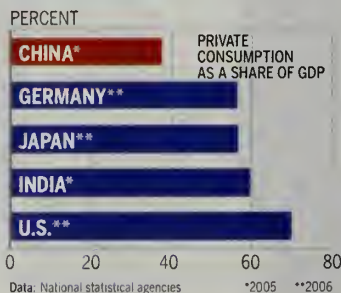
are investing in forestry, farming, and fisheries even as they did away with incentives in most other areas.

Economists have generally welcomed these steps. Yet many argue that Chinese leadership must move more aggressively to shift the economy toward high-paying service industries and away from manufacturing. Services make up more than 40% of China's GDP, compared with 54% in India, with its thriving outsourcing sector. Despite regular hikes in the minimum wages and efforts by Beijing to better enforce labor laws, salaries have declined from 53% of GDP in 1998 to 41.4% in 2005, compared with 57% in the U.S. "If consumption is to go up, the share of wages in economic growth will have to rise," says Bert Hofman, World Bank's chief economist in Beijing.

Meanwhile, it's Saturday, and that usually means a Xu family shopping trip to the bustling Fangzhuang district Carrefour hypermarket, one of seven French retailers operating in Beijing. What attraction? It's nearby and offers a wide

range of goods, just as important as Carrefour "has very low prices," says Michael Zhang Xiaoping. Such words will surely strike both hope and fear into multinational retailers and Beijing policymakers alike as they attempt to persuade frugal families such as the Xus to dig deeper into their wallets.

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ELECTION 2008

CANDIDATES' STUPID ACCOUNTING TRICKS

CAMPAIGN WATCH



BY EAMON JAVERS
AND RICHARD S. DUNHAM

POLITICAL CAMPAIGNS, LIKE CORPORATIONS, sometimes play games with their financial reports.

The motives are similar: Candidates, like CEOs, want to project an image of strength, momentum, and growth. Early in a Presidential campaign, contributions offer one rough measurement of whose political stock could rise over time. In the jump-started 2008 race for the White House, fund-raising is receiving more attention than ever before, as candidates strive to show that they can compete in the coming advertising wars. But numbers officially disclosed on Apr. 15 confirmed that, like their business counterparts, the financial engineers of the campaign trail are increasingly employing gimmicks to spruce up the bottom line.

BOOK EARLY

CANDIDATES KNEW that how much they could raise in this year's first quarter would become a key test of viability. Not coincidentally, several campaigns reported surges in donations on Mar. 31, the last day of the quarter.

Senator Barack Obama (D-Ill.) disclosed 3,885 individual contributions on Mar. 31. Just the day before he had only 643. The Obama campaign attributes part of the spike to a last-day push on the Internet and fund-raising "house parties" held on the night of the 31st. But campaign spokesman Bill Burton acknowledges that the Obama team counted as first-quarter income many checks that arrived in the mail after Mar. 31. Campaign rules allow wiggle room for this practice, as long as the checks were postmarked by that day, which Burton says was the case with the late Obama contributions. The campaigns of Senators Hillary Clinton (D-N.Y.) and John McCain (R-Ariz.) reported similar patterns and said they acted appropriately.

DELAY COSTS

CANDIDATES FREQUENTLY stall payments to vendors to maximize cash on hand. John Weaver, a political adviser, received \$61,000 in fees from the McCain campaign for his work during January and February. But he received nothing in



March. A campaign spokesman explains that Weaver is usually paid at the end of each month for the following month, but April was handled differently. The campaign paid Weaver on the first of April, saving \$20,000 in cash for its first-quarter tally.

Another example: Campaign staff for former Massachusetts Governor Mitt Romney were paid twice a month in January and February but then only once in March. The sole payment kept hundreds of thousands of dollars in cash on hand for the quarterly report. A Romney spokesman attributes the delay to the fact that the second March payday would have fallen on a weekend. Instead the check went out on Monday, Apr. 2.

As with the timing of contributions, federal election rules on paying bills are flexible. They allow campaigns to make payments as late as creditors will allow.

ALLOCATE DONATIONS

PRESIDENTIAL CANDIDATES raise money for both primary and general elections. But general election funds come into play only if a candidate survives to become a nominee, so campaigns put a premium on collecting primary money early. McCain donors send checks for \$4,600, intending to give the \$2,300 maximum for the primary and the general election. Campaign staffers often call such contributors and ask if the money can be booked

as primary donations from both the donor and his or her spouse. That allows a campaign to deposit all the money in the primary election fund and use it immediately. Campaign rules allow candidates plenty of room for this maneuver, though.

While most campaigns quietly seek to "reattribute" donations in this fashion, former Senator John Edwards (D-N.C.) disclosed the practice in his Apr. 15 report. The campaign says it acted legitimately to boost donations.

MANAGE EXPECTATIONS

CAMPAIGNS LIKE to surprise the media with strong numbers, so they circulate artificially low quarterly predictions. Just after Clinton announced her Presidential bid in January, campaign aides told supporters they hoped to raise \$10 million by Mar. 31. Clinton

in fact raised \$26 million. Meanwhile, just one day before the end of the quarter, an unnamed Obama official told the press that he'd consider \$8 million to \$10 million to be a good haul for the first quarter. Obama did much better, reporting \$25 million. ■

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CIVIL SUITS

THE VANISHING TRIAL

As court battles become more rare, some experts fear the effects on the law



BY MICHAEL OREY

ATOWERING STATE courthouse that opened in downtown Houston last year boasts 39 courtrooms and expansion space for more. But lawyers in the city say the new building, built to handle civil lawsuits, is often eerily empty. The reason: So few cases are going to trial.

The federal courthouses in the northern district of Florida, a sprawling region that includes Tallahassee, Pensacola, and Gainesville, have been similarly quiet in recent months. The four federal judges in the district presided over just 12 civil trials in 2006 and 5 in 2005.

Around the country, plenty of lawsuits are getting filed, but fewer and fewer are going to trial. The civil trial is one of the most iconic American institutions, a time-honored forum where disputes over injuries, divorces, and all manner of business disasters are resolved. Yet rising legal costs, decreasing judicial tolerance for weak lawsuits, and the surging use of alternative dispute resolution (ADR) are combining to make courtroom showdowns exceptional occurrences.

After peaking at 12,018 in 1984, the number of civil trials in all federal dis-

trict courts has dropped precipitously, reaching a new low of 3,555 last year. That's almost half the number of federal trials that took place 40 years ago, even though the number of suits filed during the same period soared from 66,144 to 259,541. Now the U.S. Securities & Exchange Commission is considering a contentious proposal to allow federal shareholder lawsuits to be handled through arbitration, a move that could siphon additional lawsuits out of the court system.

University of Wisconsin law professor Marc Galanter has dubbed this trend "vanishing trial." It has also played out in state courts. In 21 states for which data were available, the number of civil jury trials fell 40% from 1976 to 2004.

Is this development worrisome? Some in the legal community are happy that trials are becoming rarer. Courtroom litigation is "a very inefficient process" for many cases, says Victor Schachter, a lawyer in Mountain View, Calif., who represents companies in employment suits.

OUT OF COURT

ARBITRATION AGGRAVATION

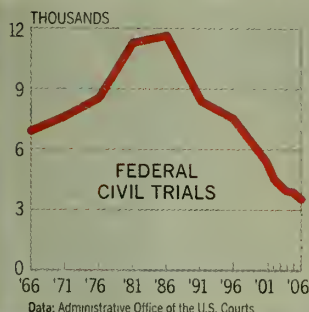
DONALD A. BURLERSON has a confession to make. He's the general counsel of Jani-King International Inc., an Addison (Tex.) commercial-cleaning operation with 12,500 franchisees worldwide. Because franchising is such a contentious business, companies in it frequently use arbitration agreements to keep disputes out of court. But Burlerson doesn't like arbitration. One reason: These days, he says, it too closely resembles the courtroom

litigation it was supposed to replace.

Burlerson is not alone. Business attorneys say arbitration is losing its luster among a growing number of their clients. "There was this notion back in the 1980s that arbitration would be a more streamlined, more cost-effective mechanism to resolve disputes," says J. Cary Gray, at Looper Reed & McClellan in Houston. "I'm telling you that it's not."

In arbitration proceedings, a single

COURT IS ADJOURNED



et others are wor-
with concerns
g from the pro-
id to the practical.
an L. Hecht, senior
ice on the Texas Su-
ne Court, says that
drop in the number
ials is resulting in a
ction in the num-
of precedents—the
le rulings that tell

ple and businesses how to behave
hanging and legally ambiguous cir-
stances. "I think it's a detriment if
ose the development of the common
through cases and appeals that have
the [basis of the] rule of law in this
try since its founding," says Hecht.
ners at law firms, meanwhile, won-
how their younger lawyers will ever
lop the skills needed to try cases.

companies began flocking out of the
t system in the 1980s, steering dis-
into alternative procedures such as
iation (nonbinding settlement dis-
sions) or arbitration (in which a paid
rator or panel of three arbitrators
des a case). On a daily basis, millions
mericans, wittingly or unwittingly,
r into agreements to waive their
t to go to court. Cell-phone carriers,
erage firms, employers, and others
monly require individuals to submit
utes to binding arbitration.

These provisions can be controversial,
the recent push by business groups
ave the SEC allow corporations to
nt shareholder lawsuits into arbitra-
provokes sharp criticism. "What
re saying is that when you've been
auded, you've got to go to their
ate forum, not a public forum,"
es Damon Silvers, associate gen-
counsel for the AFL-CIO. "There's

a mountain of evi-
dence that these kinds
of things are captive
of the industry." The
concern is that arbitra-
tors will be reluctant to
rule against companies
who they would like
to serve again. Ironi-
cally, the move to put
this issue on the SEC
agenda comes on the

heels of data showing that in 2006 the
filing of shareholder class-actions fell to
its lowest level in a decade. There is also
evidence that arbitration is falling out of
favor with some companies, particularly
as a way of resolving disputes with other
businesses (box).

PRUNING THE DOCKETS

STILL, WHAT AMOUNTS to private jus-
tice remains popular, partly because it
is shielded from the public. In Seattle
and surrounding King County, Wash.,
for example, a cottage industry of retired
judges has risen up to resolve not just
commercial disputes but also the divorce
and child custody battles of the region's
many high-tech millionaires in proceed-
ings that are fast and confidential.

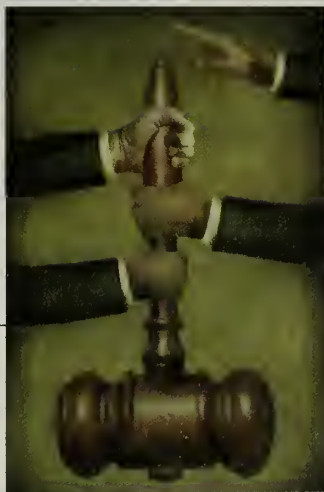
Other developments are also contribut-
ing to the trial drought. Changes to liabil-
ity laws passed in many states have simply
closed the door to many
types of personal injury
claims. Limits on dam-
ages, for example, have
caused a sharp falloff
in medical malpractice
lawsuits in a number of
states.

Judges themselves
have also become much
more aggressive about

pruning their dockets, resolving cases
through summary judgment, or pressur-
ing parties to mediate or settle. That's
not necessarily bad, but some say it's
gone too far. "There's a divide in the
judiciary," says William G. Young, a
federal district judge in Boston. Some
judges, he says, see their job as "manag-
ing" disputes and avoiding trial. Others,
including himself, do not shy away from
trials and think they play a critical role
in American justice. In a July, 2003, let-
ter to his fellow federal district judges,
Young invoked Alexis de Tocqueville to
lament that "the American jury system
is withering away," and that without jury
trials, the courts' "status as the grass-
roots guardians of constitutional values
is threatened as never before."

Susan J. Craighead, a court commis-
sioner in Washington State, echoes Justice
Hecht's concerns about the diminished
potential for development of the common
law, which comes primarily from appel-
late courts issuing written opinions about
trials. That's a matter of particular import
to businesses as they push into new areas,
be it biotech or blogs. "The law, to develop
in a relevant way, has to be in touch with
what is going on," says Craighead. "With
private disputes, you can't get that."

David Berg, a longtime Houston trial
lawyer, sees a future devoid of the court-
room dramas that have long captured
the American imagination. In a manual on
trial technique that he
published last year, Berg
wrote that he feared that
"the great war stories of
the next generation of
trial lawyers would be-
gin, 'And then, I looked
that mediator in the eyes
and I said....'" ■



tor, or sometimes a panel of three,
ers evidence and then issues a ruling.
ceedings are conducted in private,
t decision in most cases is not subject
t review. As originally conceived, the
re was supposed to be faster and cheaper
ing to court.

often as not, Gray says, arbitration
is, seem to generate litigation, not skirt it.
can go to court to battle over whether
tion is required; then, if it is, they can
back in court fighting over the award or
to get it enforced.

Discovery, the protracted pretrial
haging of documents and taking of
ositions, is supposed to be sharply limited
arbitration. The reality, however, is that many

arbitrators are allowing
extensive and expensive
discovery. Attorneys bear
some of the blame, says
Larry A. Jordan, a retired
judge who now handles
arbitration and mediation at a private Seattle
firm, Judicial Dispute Resolution. "They're used
to a complete discovery," he says. "They feel
obligated to do that."

Jordan's services aren't free. While
taxpayers pick up judicial salaries, arbitrators
draw their big paychecks from the parties
who appear before them. Houston litigator
David E. Warden says that for an arbitration he
has scheduled later this year, the three panel
members are each asking for retainers of

\$40,000. Another concern
is that arbitrators, who
often specialize in areas
such as construction
claims, may have trouble
being truly impartial

because they are beholden to the industry
they work for. The worry is that the arbitrators,
who want repeat business, won't want to
offend either side and so will essentially split
the baby to resolve disputes. Warden says his
firm, Yetter & Warden, has energy industry
clients who now regret some of the mandatory
arbitration clauses they are subject to. Says
Warden: "They're looking around and saying,
'Maybe the court system isn't so bad—at least
you get due process at some point.'" ■

MARKETING

QUEEN OF THE PRODUCT PITCH

Martha Stewart isn't shy about integrating ads into her show

BY BURT HELM

IT'S JUST FOUR MINUTES INTO AN Apr. 4 episode of *The Martha Stewart Show*, and Donna Brock from Cleveland, Tex., is on the line asking for advice on how to clean her bathroom. Simple, Stewart says: "Disposable toilet scrubbers, from Scotch-Brite." She plucks a scrubber wand from a box and goes to town on a toilet in the middle of the studio. Watching from home, Brock notes how easy the wand is to use under the bowl's rim.

A segment about a disposable toilet brush might seem a trifle déclassé for Stewart, who built her aspirational brand on meticulously crafted decorations and gourmet meals. But there's a backstory: 3M, which owns the Scotch-Brite brand, helped develop and pay for the five-minute segment as part of a sweeping, multi-million dollar advertising deal.

Television has long worked products into dramatic story lines—and more so since advertisers began fleeing to the Web. Now such "brand integrations" are becoming common on daytime talk shows. Who better to sing the merits of a product than the beloved hosts of *The Martha Stewart Show*, *The Ellen DeGeneres Show*, or *The View*? To a greater or lesser degree, all are working product mentions into their shows in exchange for flat fees or a big ad buy.

But no one is pushing the envelope more energetically than Stewart. Yes, she is walking a fine line by calling herself "America's most trusted guide to stylish living" while taking money to promote products. But she is breathtakingly candid about the practice and contends this is simply business as usual nowadays. "I like to inform people about good things," she says. "And many of these products that are good things might not be known by a lot of people. So why not integrate them, and get paid for it?" As long as she sticks to promoting products she really believes in, Stewart argues, it won't dilute her brand or abuse the trust of her 1.7 million viewers.

It's not hard to see why Stewart & Co. love ad integrations. Because the show currently lags behind competing

talk shows in the ratings, it can command only \$10,000 on average for a traditional 30-second spot, vs. as much as \$18,000 at *The View* or about \$100,000 over at *The Oprah Winfrey Show*.

The hook for advertisers: Buy at least \$250,000 worth of 30-second spots and get the chance to help create a branded segment on the show, not to mention work your messages into Martha's other properties, such as her magazines or Sirius radio channel. Usually, such segments are free with large ad buys. When the airtime is sold out



(which it has been since December the 2006-07 season), the show will sell branded segments à la carte. \$100,000 you get "a short verbal visual" of the product, says Liz man, senior vice-president for advertising sales at the broadcast unit of Martha Stewart Living Omnimedia Inc. (MS). A two-minute-plus segment that works in an advertiser's talking points starts at \$250,000.

Advertisers are understandably enthusiastic. Last year, nearly a fifth of episodes contained segments that were sponsored and shaped by major advertisers, including 3M, L'Oréal, Kraft Foods, and General Pacific. (The number probably would have been even higher had the show imposed a cap on them.) "When you get an endorsement from someone like Martha Stewart, moms in our target audience take cues from her," says Erik Sjogren, senior brand manager of Dixie, talking about a segment in which Martha recommen-

Cleaning Up

Three ways to buy time with Stewart

30-second spot on *The Martha Stewart Show*

\$10,000

One-time in-show oral mention with product close-up

\$100,000

Two-minute-plus branded segment, with two to three talking points

\$250,000+

Data: Martha Stewart Living Omnimedia Inc. BusinessWeek



Koman. "That's important to us." Even so, which products get used and how they're worked into the show depends on "fit," says Koman. "It needs to fit into themes like entertaining and housekeeping, in a way that informs our viewers."

Some brands require workarounds to be consistent with what Stewart stands for. Consider an integration in the works for a butter substitute. Stewart loves butter, and she has long advocated that people eat smaller portions of rich foods rather than ample portions of a "diet" version. So Koman is considering having Dr. Brent Ridge, a health expert who loves the butter substitute, join Martha for a segment on healthy eating. He could acknowledge that Martha loves butter, Koman says, but also recommend the substitute for people with high cholesterol (she notes that the segment is still contingent on Stewart's approval).

The Scotch-Brite toilet scrubber segment, which is part of the biggest multimedia deal MSLO has ever done, required similar adjustments. To do the segment, the production team sorted through viewer correspondence (Stewart receives about 1 million pieces a year) until they found a letter that fit the bill. After getting in touch with Donna Brock, they briefed her to speak concisely during the segment and to ask good lead-in questions about the scrubber.

"I like to tell people about good things"

But there was a problem: Stewart hadn't used the scrubber before the segment was taped and wasn't sure she actually would ever want to use it personally. "I could see it being used elsewhere, and it works very

well," says Stewart, "but it was disposable, and it's kind of wasteful." So Stewart decided to reconfigure the first part of the segment. She would start off by highly recommending a Scotch-Brite product she really did use and love, their trademark yellow sponge with the green abrasive backing. "Then I said: 'This is the newest product from the Scotch-Brite people,'" and favorably compared some of its features to the sponge. "So that got it into the program very nicely."

Some brands, meanwhile, are completely off-limits, Koman says. A diet pill company called LA Weight Loss, for instance, is one of the show's biggest advertisers. Hard to square a diet pill with gourmet living. ■

e Cups as a way to keep kids healthy. For us it was a slam dunk."

typically takes three weeks for advertisers and MSLO to put together a segment. A product may be used as an ingredient in a cooking segment, as the host of a giveaway, or in response to viewer mail. After MSLO decides to include a product and determines how it will appear, it asks the client to supply one or three talking points.

Last fall, Hewlett-Packard Co. wanted Stewart to mention three things about the Photosmart R817 camera when it was featured in a segment on "How to take pictures." HP wanted her to mention the name of the camera, how it differed from other models, and that it would be a great holiday gift. Stewart did HP one better: She covered all three points and held up the user manual, according to Karen Cage, a marketer at HP. "Martha always overdelivers," she says.

To reinforce the message, advertisers

typically use their talking points in 30-second ads run directly after the product placement segments. On Mar. 15 the show ran a 2-minute, 40-second segment in which Stewart explored how Dixie cup styles have changed in the past 80 years. During the segment, she encouraged parents to "teach kids good hygiene by having a dispenser right in your kitchen." As the segment ended, a Dixie logo appeared and a voice intoned: "This segment was brought to you by the maker of Dixie." Then came a 30-second Dixie spot focused on hygiene-challenged plastic cups.

THE FIT MATTERS

HOW MUCH THE advertiser spends throughout the MSLO empire, which includes a Web site, radio station, TV show, and magazines, can affect what the company is willing to do. "One of the first things Martha will say to me is: 'How much is it worth to the company? How important is it to the company?'" says



RUSSIA

THE KREMLIN'S BIG SQUEEZE

A BP venture is the latest target as Moscow muscles in on producers

BY JASON BUSH

IT'S ONE OF JOHN BROWNE'S BIGGEST personal triumphs. In September, 2003, the CEO of oil giant BP sealed a deal to create TNK-BP, a joint venture that would become Russia's fourth-largest oil company and which today accounts for a quarter of the British company's global production. Now Browne's designated successor, Tony Hayward, is surely counting on the project to keep the oil—and profits—pumping, particularly after a year that saw BP's reputation and stock hammered because of repeated missteps in production and safety. One sign of TNK-BP's importance: Browne and Hayward met with Russian President Vladimir

V. Putin at his dacha outside Moscow in March to discuss the venture.

There's a lot to discuss. BP clearly wants to preserve the lucrative partnership it built with tycoons Mikhail Fridman, Viktor Vekselberg, and Len Blavat-

nik—a unique 50-50 venture that gave the Western company unprecedented access to vital Russian oil and gas. But it may have to accept some changes as the Kremlin continues strengthening its grip on energy. Speculation is swirling that the tycoons may sell out to Gazprom, the state gas giant.

A more pressing issue concerns a Siberian gas field called Kovykta, which boasts 1.9 trillion cubic meters in reserves. Russian officials say TNK-BP hasn't fulfilled the terms of its license, which requires production of 9 billion cubic meters of gas a year, about 18 times its current output. If the shortfall isn't corrected by May, the government says, the license will be revoked and auctioned anew. "The West is always demanding that we do this strictly by the law, and here we're acting strictly by the law," says Oleg Mitin, deputy head of Russia's Federal Resource Management Agency.

For TNK-BP, though, compliance doesn't seem to make much sense. The company estimates domestic demand for the gas to be less than a third of the required output, but TNK-BP is barred from exporting gas, a privilege reserved for Gazprom. Although TNK-BP has asked Gazprom to team up on Kovykta, the company hasn't made any decision. In January the joint venture's CEO, Robert Dudley, said he hoped to reach an agreement with Gazprom by midyear.

Most in the industry assume the headline is a negotiating tactic, not un-

TNK-BP at a Glance

REVENUES	\$31.3 billion
NET INCOME	\$6.7 billion
PROVEN RESERVES	7.8 billion barrels*
PRODUCTION	1.9 million barrels* per day
SHARE OF BP'S TOTAL OUTPUT	25%

*Oil equivalent Data: BP TNK-BP Deutsche UFG

pressure applied to Royal Dutch Shell PLC last year. After Shell was accused of environmental violations at a project on Sakhalin Island in the Russian Far East, the company sold a majority stake to Gazprom. "The most likely scenario is that the [TNK-BP's Kovykta] license won't be revoked, but Gazprom will come into the consortium," operating the field, says Ilya Nesterov, an analyst at investment bank Troika Dialog.

ALL-CONNECTED PARTNER?

THE QUESTION IS what TNK-BP might be able to get for its stake. Speculation in the market ranges from cash to swaps to partnerships in other energy projects with Gazprom. If the terms are acceptable to BP and its Russian partners, development at Kovykta might pick up speed. Company officials say it would cost \$20 billion to develop the field and build pipelines. But that might not be profitable without exports—most likely to China and South Korea—which could be permitted if Gazprom is on board.

A deal with Gazprom on Kovykta may solve all of TNK-BP's problems. Some say that pressure on the company will continue until Gazprom gets a big stake in the entire venture, not just the Kovykta field. Gazprom last year declared its interest in buying out BP's Russian partners, which could happen after the end of 2007, when the joint venture agreement allows for changes in the company's share structure. Would BP want to work that closely with Gazprom? It might mean ceding some strategic decisions to Gazprom's management, which has close ties to the Kremlin. Still, BP shows no signs of losing interest in Russia. The company owns a minority stake in a venture with the oil giant Rosneft to drill for crude oil on Sakhalin Island. And last year BP acquired 35 new operating licenses in the country and plowed \$1.25 billion into TNK-BP. This year it's likely to invest about that much again.

Despite the tension over Kovykta, BP has tried hard to maintain good relations with Moscow. It snapped up \$1 billion in Rosneft shares last year when the Kremlin canvassed support for the company's initial public offering in London. And by bidding in a controversial auction of assets of bankrupt company Yukos, it helped legitimize the sale to Rosneft. That may be the key for global oil companies that want to do business in Putin's Russia. ■

—With Stanley Reed in London



ABRAMOVICH His Evraz is hungry for American steel outfits

DEALS

RUBLES ACROSS THE SEA

Russian companies are on a global buying spree

BY JASON BUSH

A "SURPRISE BID." That's the way much of the world press described the decision by Russian national airline Aeroflot to join in the pursuit of Italian carrier Alitalia. Europeans were also surprised last September when Moscow-based Vneshtorgbank spent \$1 billion for a 5% stake in European aerospace concern EADS. The same goes for the \$2.3 billion cash buyout last November of Oregon Steel Mills Inc. by Russian steelmaker Evraz—the country's largest overseas deal yet.

Get used to the surprises: There's a new breed of corporate dealmakers hailing from the east. Russian companies last year spent \$13 billion on overseas acquisitions, up from \$1 billion in 2002, according to market tracker Dealogic. Including spending on

existing ventures, the Russian Central Bank says foreign direct investment from Russia last year totaled \$18 billion, five times the level in 2002.

Russian companies can afford to splurge. The country is awash in cash from exports of oil, gas, and metals, which helped boost its current-account surplus to \$94 billion last year. That is flowing into all corners of the economy, so even companies far removed from the energy sector have plenty of spending money. "It's hardly surprising that companies are looking for opportunities abroad," says Roland Nash, head of research at Moscow investment bank Renaissance Capital.

Russian money, though, doesn't always get a warm welcome. Gas giant Gazprom sparked a media furor in Britain last year when it said it might bid for Centrica PLC, Britain's No. 1 gas supplier. Russian companies lost international deals worth \$50 billion in 2006, in part because of political attitudes, Foreign Minister Sergei Lavrov told a meeting of business leaders in Moscow in February. As a result, Gazprom and others have hired Western public-relations consultants to polish their image.

Despite such obstacles, there's little doubt the Russian acquisition trend will intensify. Many big Russian companies see expansion into international markets as a necessary step in their development. Energy and metals groups want to move beyond raw materials into higher-profit areas such as refining and manufacturing. Steelmaker Evraz, controlled by tycoons Roman Abramovich and Alexander Abramov, is rumored to be considering a bid for Ipsco Inc., a pipemaker in Illinois. (Evraz had no comment.) Russia's telecommunica-

tions companies are on the prowl, too. Altimo, a holding company that owns mobile-phone operator VimpelCom, has taken out a \$1.5 billion loan to fund acquisitions in India, Indonesia, and Vietnam. "The saturation of the market means we are looking beyond Russia's borders," says Altimo Vice-President Kirill Babaev. These days, any such deal should come as no surprise. ■

THE STAT

\$13 Billion

Value of Russian overseas M&A deals in 2006

Data: Dealogic

HYDERABAD
Supermarket shopping comes to Banjara Hills



SHOPPING SHAKEUP

WIDENING AISLES FOR INDIAN SHOPPERS

Big retailers are jostling to replace millions of small merchants with chain stores

BY STEVE HAMM AND
NANDINI LAKSHMAN

IT'S A SCENE THAT WOULD BE positively ho-hum in any U.S. supermarket: Shoppers carefully select perfectly ripe tomatoes from a bin, place them in a plastic bag, weigh them on a digital scale, then slip the bag into a clean shopping cart. But what's no big deal for Americans is unusual in India.

The store is a newly opened Reliance Fresh produce shop in the southern city of Hyderabad. With 200 different types of fruits and vegetables displayed along brightly lit, air-conditioned aisles, the compact store is a revelation for many middle-class Indians. "It's good to shop here—the cleanliness, the prices—everything," says Sarah Khan, a burka-clad shopper with two children in tow.

A retail revolution is sweeping India. For decades, Indians have largely relied on *kirana* stores—tiny neighborhood shops—and produce markets, where the fruit and vegetables are often well past their prime. But Reliance Industries Ltd. and other Indian conglomerates are

changing that. All told, investors both local and foreign plan to spend more than \$25 billion over the next five years to change the way Indians shop. The prize? A retail market that is expected to surge to \$637 billion by 2015 from some \$300 billion today.

Problem is, the road to retail riches in India runs uphill. The market is dominated by 12 million mom-and-pop stores, and those small-time merchants aren't going to let the big boys in without a fight. They've already staged several protests calling on the government to stop the conglomerates from sweeping them aside. "These big companies are luring our customers with discounts, and this shouldn't be done," says Dhajibhai Ravji, an elderly *kirana* shop owner in suburban Mumbai.

Keeping shelves stocked can be a challenge, too. India's narrow roads slow traffic to a crawl, and the country has only 1,500 refrigerated trucks, so one-third of produce rots before reaching customers. Finding a good loca-

tion is also tough. With all the new retail investment, prices for suitable space have jumped by 60% in the past six months, says Vivek Kaul, head of Jones Lang LaSalle retail advisory service in India. "For a retail property, there are five tenants looking at it," Kaul says. Another consultant says Reliance is opening only 30 stores a month, down from a projected 50, because of difficulties in getting leases.

CREEPING IN

THOSE CONCERNS HAVEN'T stopped the rush into the sector. The Tata Group is opening hypermarkets and appliance shops, and the Aditya Birla Group is plowing \$2 billion into a national chain of supermarkets. And while foreign retailers are largely banned from setting up shop in India, multinational giants are slowly creeping in. Wal-Mart Stores Inc. is negotiating a deal to provide logistics and technology for Bharti Enterprises, an Indian conglomerate that has earmarked \$2.5 billion for food, clothing, and electronics stores. German discounter Metro operates wholesale outlets in Bangalore and Hyderabad, while France's Carrefour and Britain's Tesco are also putting out feelers.

Reliance, though, has the most ambitious plans. Since launching its first store in October, the Mumbai-based company has opened more than 100 Reliance Fresh outlets as part of a \$6 billion push into retail that will also include hypermarkets, wholesale outlets, and electronics stores. Ambitious, sure, but Reliance says it's prepared for the competition. Says Raghu Pillai, head of Reliance's retail arm: "There's room for everybody." ■

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Wal-Mart's Midlife Crisis

DECLINING GROWTH, INCREASING COMPETITION,
AND NOT AN EASY FIX IN SIGHT

JOHN E. FLEMING, WAL-MART'S NEWLY APPOINTED chief merchandising officer, is staring hard at a display of \$14 women's T-shirts in a Supercenter a few miles from the retailer's Bentonville (Ark.) headquarters. The bright-hued stretch T's carry Wal-Mart's own George label and are of a quality and stylishness not commonly associated with America's *über*-discounter. What vexes Fleming is that numerous sizes are out of stock in about half of the 12 colors, including frozen kiwi and black soot.

Fleming may be America's most powerful merchant, but a timely solution is beyond him even so. Wal-Mart failed to order enough of these China-made T-shirts last year, and so they and other George-brand basics will remain in short supply in most of its 3,443 U.S. stores until 2007's second half, depriving the retailer of tens of millions of dollars a week it sorely needs. "The issue with apparel is long lead times," says the quietly intense Fleming, who spent 20 years at Target Corp. before joining Wal-Mart Stores Inc. "We will get it fixed."

For nearly five decades, Wal-Mart's signature "everyday low prices" and their enabler—low costs—defined not only its business model but also the distinctive personality of this proud, insular company that emerged from the Ozarks backwoods to dominate retailing. Over the past year and a half, though, Wal-

Mart's growth formula has stopped working. In 2006 its U.S. division eked out a 1.9% gain in same-store sales—its worst performance ever—and this year has begun no better. By that key measure, such competitors as Target, Costco, Kroger, Safeway, Walgreen's, CVS, and Best Buy now are all growing two to five times faster than Wal-Mart (table, page 54).

Wal-Mart's botched entry into cheap-chic apparel is emblematic of the quandary it faces. Is its alarming loss of momentum the temporary result of disruptions caused by transitory errors like the T-shirt screwup and by overdue improvements such as the store remodeling program launched last year? Or is Wal-Mart doing lasting damage to its low-budget franchise by trying to compete with much hipper, nimbler rivals for the middle-income dollar? Should the retailer double its efforts to out-Target Target, or would it be better off going back to basics?

If Wal-Mart seems short of answers at the moment, it might well be because there aren't any good ones. Increasingly, it appears that America's largest corporation has steered itself into a slow-growth cul de sac from which there is no escape. "There are a lot of issues here, but what they add up to is the end of the age of Wal-Mart," contends Richard Hastings, senior analyst for the retail rating agency Bernard Sands. "The glory days are over."

Simple mathematics suggest that a 45-year-old company

BY
**ANTHONY
BIANCO**



SCOTT The CEO's full-speed-ahead expansion strategy is increasingly problematic

in an industry growing no faster than the economy as a whole will struggle to sustain the speedy growth rates of its youth. In Wal-Mart's case, this difficulty is exacerbated by its great size and extreme dominance of large swaths of the U.S. retail market. Wal-Mart already controls 20% of dry grocery, 29% of nonfood grocery, 30% of health and beauty aids, and 45% of general merchandise sales, according to ACNielsen.

However, the expansion impulse is as deeply embedded in Wal-Mart's DNA as its allegiance to cut-rate pricing. Wal-Mart was able to boost total U.S. revenues by 7.2% last year by opening new stores at the prodigious rate of nearly one a day. According to Wal-Mart CEO H. Lee Scott Jr., the company plans to sustain this pace for at least the next five years. In fact, he is on record saying that room remains in the U.S. for Wal-Mart to add 4,000 Supercenters—the largest of its store formats by far—to the 2,000 it now operates.

Does Scott, 58, recognize any limits whatsoever to Wal-Mart's growth potential in the U.S., which accounted for 78% of its \$345 billion in sales last year? "Actually, and I know it's going to sound naive to you, I don't," he replies. "The real issue is, are [we] going to be good enough to take advantage of the opportunities that exist?"

TOO CLOSE FOR COMFORT

WALL STREET DOES NOT SHARE Scott's bullishness, to put it mildly. Wal-Mart shares are trading well below their 2004 high and have dropped 30% in total since Scott was named CEO in 2000, even as the Morgan Stanley retail index has risen 180%. "The stock has been dead money for a long time," says Charles Grom, a JPMorgan Chase & Co. analyst.

Even money managers who own Wal-Mart's shares tend to see the retailer as a beaten-down value play, not a growth company. "I'd be surprised if true growth-oriented investors were involved at this point," says Walter T. McCormick, manager of the \$1.2 billion Evergreen Fundamental Large Cap Fund, which began buying the stock a year ago. "The issue the Street has is market saturation: We may be in the seventh inning of a nine-inning game."

One can argue that the deceleration of Wal-Mart's organic growth is a function of the aging of its outlets, given that same-store sales rates slow as stores mature. Outlets five years or older accounted for 17% of all U.S. Supercenters in 2000 and 44% in 2006, and will top 60% in 2010, according to HSBC analyst Mark Husson. "There's an inevitability of bad middle age," he says.

Meanwhile, the underlying economics of expansion have turned against Wal-Mart, even as it relies increasingly on store-building to compensate for sagging same-store sales. On balance, the new Supercenters are just not pulling in enough sales to offset fully the sharply escalating costs of building them. Part of the problem is that many new stores are located so close to existing ones that Wal-Mart ends up competing with itself. All in all, the retailer's pretax return on fixed assets, which includes things such as computers and trucks as well as stores, has plunged 40% since 2000.

Even many analysts with a buy on Wal-Mart want it to follow the lead of McDonald's Corp. and cut way back on new-store building to concentrate instead on extracting more value from existing stores, which vary wildly in their performance.

For Less



Wal-Mart disclosed a year and a half ago that same-store sales were rising 10 times, or 1,000%, faster at the 800 best-managed outlets than at the 800 worst-run ones. Equally shocking was its admission that 25% of its stores failed to meet minimum expectations of cleanliness, product availability, checkout times, and so on.

Scott is acutely aware of the Street's discontent. "We have to find a way to give our shareholders back the returns that they need through some mechanism," he acknowledges. In March, Wal-Mart boosted its dividend 31%. Apparently, the board is considering spinning off Sam's Club, the warehouse club division that is a perennial also-ran to Costco.

Wal-Mart announced late last year that it would trim its customary 8% annual addition to U.S. square footage to 7% in 2007. At the moment, though, slamming on the brakes is out of the question. Says Scott: "If you stop the growth at Wal-Mart, you'd be silly to think that [alone] means you're going to have better stores."

Wal-Mart's "home office" has taken a series of steps



BIG, BIG BOX
Wal-Mart sees
room for 4,000
new Supercenters

prove the performance of its far-flung store network. Last year it implemented a whole new supervisory structure that required many of its 27 regional administrators to move out of Bentonville and live in the districts they manage. In April, Scott removed the executive in charge of U.S. store operations and put her in charge of corporate personnel instead.

The number of stores falling below the threshold of minimum customer expectations has declined but remains "more than would be acceptable," says Scott, who is surprisingly philosophical about the persistence of mediocrity. Asked why it has been so difficult to fix bad stores, he replies: "That's a very good question. It's a question I ask all the time."

The polite, self-deprecating Scott is no Robert L. Nardelli, whose ouster as Home Depot Inc.'s chief had as much to do with his abrasive personality as the chain's business problems. That said, Wal-Mart's stock has performed worse under Scott than Home Depot's did under Nardelli. "The Street is going to look at the back half of 2007 for evidence of improvement," says an adviser to a large, longtime Wal-Mart shareholder. "If that doesn't

happen, you're going to see a tremendous amount of pressure."

Scott & Co. already are struggling to cope with mounting sociopolitical backlash to Wal-Mart's size and aggressive business practices. Over the past decade, dozens of lawsuits were brought by employees claiming to be overworked and underpaid, including the mother of all sex discrimination class actions. Organized labor set up two Washington-based organizations to oppose the antiunion employer at every turn. And hundreds of municipalities across the country erected legal obstacles of one kind or another.

Wal-Mart's initial reaction to the gathering storm of opposition was to ignore it and maintain the defiant insularity that is a legacy of its Ozarks origins. "The best thing we ever did was hide back there in the hills," Sam Walton, the company's legendary founder, declared shortly before his death in 1992.

In the past few years, Scott has reluctantly brought Wal-Mart out from behind its Bentonville barricades. Virtually from scratch, this famously conservative company has built a large public and government relations apparatus headed by

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Food

Wal-Mart already controls 17% of perishable food in the U.S.



Fashion

The in-house George label is tonier than the norm, but distribution has been spotty

Leslie A. Dach, a veteran Washington political operative of pronounced liberal bent. Few CEOs have embraced environmental sustainability as avidly as has Scott, who also broke with the Republican orthodoxy of his predecessors by advocating a hike in the federal minimum wage.

It's not just rhetoric: Wal-Mart has indeed made substantive reforms in some areas. It has struck up effective working relationships with many of the very environmental groups it once disdained. No less dramatically, the company has added three women (one is Hispanic) and two African American directors to its board and also tied all executive bonuses to diversity goals.

It turns out, though, that there is a dark, paranoid underside to Wal-Mart's visible campaign of outreach. What began as an attempt by Wal-Mart's Threat Research and Assessment Group to detect theft and pro-union sympathies among store workers grew into surveillance of certain outside critics, consultants, stockholders, and even Wal-Mart's board. Bruce Gabbard, a security technician fired for allegedly unauthorized wiretapping of a *New York Times* reporter, has described himself as "the guy listening to the board of directors when Lee Scott is excused from the room."

Wal-Mart's spreading Spygate scandal is perhaps the most damaging in a long

sequence of PR disasters, including last year's conviction of former No. 2 executive Thomas M. Coughlin on fraud and tax evasion charges stemming from embezzlement of company funds. Coughlin, a Walton protégé who had been Scott's leading rival for the CEO post, is serving a sentence of 27 months of house arrest.

There is no way of measuring how much business Wal-Mart is losing to competitors with more benign reputations. According to a recent survey conducted by Wal-Mart itself, though,

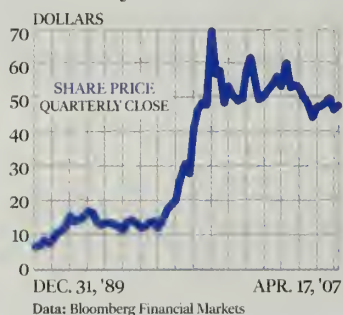
14% of Americans living within range of one of its stores—which takes in 90% of the population—are so skeptical of the company as to qualify as "conscientious objectors."

But the Arkansas giant's fundamental business problem is that selling for less no longer confers the overwhelming business advantage it once did. Low prices still define the chain's appeal to its best customers, the 45 million mostly low-income Americans who shop its stores frequently and broadly. But the collective purchasing power of the "loyalists," as Wal-Mart calls them, has shriveled in recent years as hourly wages have stagnated and the cost of housing and energy have soared.

More affluent shoppers also walk Wal-Mart's aisles in great numbers, but they tend to buy sparingly, loading up on toothpaste

Wal-Mart's slumping stock price

"Dead money" since the turn of the century



bad (as in good)

bad (as in bad)



cing

the goods are still cheap, Wal-Mart
n vin on price the way it used to



Shoppers

Middle America isn't flocking as it did,
and richer shoppers buy more selectively

tergent, and other "consumables" priced barely above cost
ile shunning higher-margin items such as clothes and fur-
ure. To the selective middle-income shopper, quality, style,
vice, and even store aesthetics increasingly matter as much
price alone. "Here's the big thought Wal-Mart missed: Price
not enough anymore," says Todd S. Slater, an analyst at Laz-
l Capital Markets.

ACKWOODS KNOWHOW

FIRST, WAL-MART MANAGEMENT blamed its loss of mo-
entum mostly on rising gasoline prices—a theory undercut
en same-store sales kept falling even as the cost of gas
eded during the latter half of 2006. Today, Wal-Mart execu-
es are more willing to acknowledge the X factor of intensi-
d competition. Says Fleming: "We're now up against world-
ss competitors that are each taking a slice of our business."
Wal-Mart not only was slow to recognize this threat but also
sponded haphazardly once it did. The nub of the problem
s that the discounter had relied for so long on selling for
s that it did not know any other way to sell. Wal-Mart did
t begin to build a marketing department worthy of the name
til Fleming was named to the new position of chief market-
g officer in spring, 2005, an appointment Scott hailed as "an
raordinary move for us."

Founded in 1962, Wal-Mart rose to dominance on the
length of its mastery of retailing's "back-end" mechanics.
rced by the isolation of the Ozarks to do for itself what most

retailers relied on others to do for them, Wal-Mart built a cut-
ting-edge distribution system capable of moving goods from
factory loading dock to store cash register faster and cheaper
by far than any competitor. It added to its cost advantage by
refusing to acquiesce to routine increases in wholesale prices,
continually pressing suppliers to charge less.

Walton, who was both a gifted merchant and a born tight-
wad, also pinched pennies in every other facet of business,
from wages and perks (there were none) to fixtures and fur-
nishings. Aesthetics counted for so little that when the retailer
finally put down carpet in its stores it took care to choose a
color that matched the sludgy gray-brown produced by mixing
dirt, motor oil, and the other contaminants most commonly
tracked across its floors. To Wal-Mart, the beauty of its hideous
carpet was that it rarely needed cleaning.

Low costs begat low prices. Instead of relying on promo-
tional gimmickry, Wal-Mart sold at a perpetual discount
calculated to make up for in volume what it lost in margin.
Walton's philosophy was price it low, pile it high, and watch it
fly. His belief in everyday low prices made him a populist hero
even as he built America's largest fortune. (His descendants
still own 40% of Wal-Mart's shares, a stake worth \$80 billion.)
Regulators forced "Mr. Sam" to modify his slogan of "Always
the lowest price" to the hedged "Always low prices!" But hun-
dreds of retailers went broke trying to compete with Wal-Mart
on price just the same.

In many ways, Wal-Mart has remained reflexively tight-
fisted under Scott, a 28-year company veteran who trained

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at Walton's knee and rose to the top through trucking and logistics. Last year, Wal-Mart began remodeling the apparel, home, and electronics sections in 1,800 stores, replacing miles of that stain-colored carpeting with vinyl that looks like wood. To Fleming, the new "simulated wood" floor is all about aesthetic improvement. His boss takes the classical Wal-Mart view. "The truth is that vinyl costs less," Scott says. "And the maintenance on the vinyl costs less than the maintenance on the carpet."

Yet Wal-Mart is neither as low-cost nor as low-price a retailer as it was in Walton's day, or even when Scott moved up to CEO. Most dramatically, overhead costs jumped 14.8% in 2006 alone and now amount to 18.6% of sales, compared with 16.4% in Scott's first year—a momentous rise in a business that counts profit in pennies on the dollar.

The imperatives of reputational damage control have prompted Bentonville to add hundreds of staff jobs in public relations,

jobs, remodeled stores, and replaced warehouses, investing heavily in new technology to tie it all together. Unionized supermarkets even managed to chip away at Wal-Mart's non-union-labor cost advantage, signaling their resolve by taking a long strike in Southern California in 2003-04. The end result: Rival chains gradually were able to bring their prices down closer to Wal-Mart's and again make good money.

Consider the return to form of Kroger Co., the largest and oldest U.S. supermarket chain. Cincinnati-based Kroger competes against more Wal-Mart Supercenters—1,000 at last count—than any other grocer. Which is why until recently the only real interest Wall Street took in the old-line giant was measuring it for a coffin. Today, though, a rejuvenated Kroger is gaining share faster in the 32 markets where it competes with Wal-Mart than in the 12 where it does not.

A recent Bank of America survey of three such markets—Atlanta, Houston, and Nashville—found that Kroger's prices were 7.5% higher on average than Wal-Mart's compared with 20% to 25% five years ago. This margin is thin enough to allow Kroger to again bring to bear such "core competencies" as service, quality, and convenience, says BofA's Scott A. Mushkin, who recently switched his Kroger rating to buy from sell. "We're saying the game has changed, and it looks like it has changed substantially in Kroger's favor," he says.

While Wal-Mart vies with a plethora of born-again rivals for the trade of middle-income Americans, it also must contend on the low end of the income spectrum with convenience and dollar-store chains and with such "hard discounters" as Germany's Aldi Group. These no-frills rivals are challenging Wal-Mart's hold over budget-minded shoppers by underpricing it on many staples.

To right Wal-Mart's listing U.S. flagship division, Scott installed Eduardo Castro-Wright as its president and CEO in fall, 2005. The Ecuador-born, U.S.-educated Castro-Wright, now 51, worked for RJR Nabisco and Honeywell International Inc. before joining Wal-Mart in 2001. In Castro-Wright's three years as CEO of Wal-Mart Mexico, revenues soared 50%, powered by sparkling same-store sales growth of 10% a year.

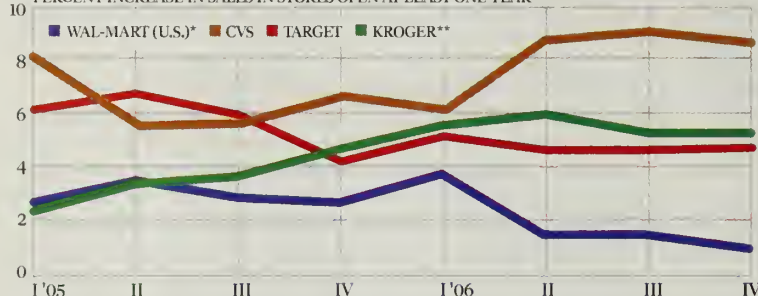
To date, Castro-Wright has fallen so far short of replicating the miracle of Mexico that in January he had to publicly deny rumors that he was about to be transferred back to international. Instead, Scott shifted the vice-chairman over to Castro-Wright to new duties. That the U.S. chief now reports directly to Scott both solidifies Castro-Wright's status and ups the pressure on him to show results.

Castro-Wright can point to progress on the cost side of the ledger. By tightening controls over the stores, headquarters has halved the growth rate of inventories to 5.6% from 11.5% two years ago. Wal-Mart also has squeezed more productivity out of its 1.3 million store employees for eight consecutive quarters. This was done by capping wages for most hourly positions, converting full-time jobs to part-time ones, and installing a sophisticated scheduling system to adjust staffing levels to fluctuations in customer traffic.

Wal-Mart has found other new ways to economize, notably by cutting out middlemen to do more contract manufacturing overseas. The company's much publicized green initiative have tempered criticism from some left-leaning opponents but are perhaps best understood as a politically fashionable manifestation of its traditional cost-control imperative.

Key rivals outrun Wal-Mart

PERCENT INCREASE IN SALES IN STORES OPEN AT LEAST ONE YEAR



*DOES NOT INCLUDE SAM'S CLUB **NOT INCLUDING FUEL SALES
Data: Company reports, JPMorgan Chase & Co., Bank of America

corporate affairs, and other areas that the company happily ignored when it was shielded by the force field of Walton's folksy charisma. And as the nation's largest electricity consumer and owner of its second-largest private truck fleet, Wal-Mart was hit doubly hard by the explosion of energy costs.

Wal-Mart also has purposefully, if not entirely voluntarily, inflated its cost base in expanding far beyond its original rural Southern stronghold. It is far more expensive to buy land and to build, staff, and operate stores in the large cities that are the final frontier of Wal-Mart's expansion than in the farm towns where it began. Then, too, the company is encountering mounting resistance as it pushes deeper into the Northeast, Upper Midwest, and West Coast, requiring it to retain legions of lawyers and lobbyists to fight its way into town.

NARROWING THE GAP

UNDER SCOTT, WAL-MART even blunted its seminal edge in distribution by letting billions of dollars in excess inventories accumulate at mismanaged stores. A dubious milestone was reached in 2005 as inventories rose even faster than sales. "You'd see these big storage containers behind stores, but what was more amazing was that [local] managers were going outside Wal-Mart's distribution network to subcontract their own warehouse space," says Bill Dreher, a U.S. retailing analyst for Deutsche Bank.

Over the past decade, top competitors in most every retailing specialty have succeeded in narrowing their cost gap with Wal-Mart by restructuring their operations. They eliminated



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By any conventional measure, Wal-Mart remains a solidly profitable company. Rising overhead costs have cut into net income, which in 2006 rose a middling 6.7%, a far cry from the double-digit increases of the 1990s. Return on equity continued to top 20%, however, and U.S. operating margins actually have widened a bit under Castro-Wright, as costs have risen a bit slower than Wal-Mart's average selling price.

Evidently, though, it is going to take a lot more than Castro-Wright's workmanlike adjustments to revive Wal-Mart's eribund stock. In the end, Scott's aversion to a McDonald's-style strategic about-face leaves Wal-Mart no alternative but to grow its way back into Wall Street's good graces. But if opening a new Wal-Mart or Sam's Club almost every day can't move the dial, what will?

Foreign markets present an intriguing mix of potential

and peril for Wal-Mart, which first ventured abroad in 1992. Although the company now owns stores in 13 countries, the lion's share of those revenues comes from Mexico, Canada, and Britain. In 2006 international revenues rose 30%, to \$77 billion. At the same time, though, Wal-Mart's long-standing struggles to adapt its quintessentially American low-cost, low-price business model to foreign cultures was underscored by the \$863 million loss it took in exiting Germany.

Wal-Mart is the rare U.S. company that is more politically constrained at home than abroad in angling for outside growth opportunities. In March it withdrew its application for a Utah bank charter just before a congressional committee was set to convene hearings. The retreat marks an apparent end to its decade-long campaign to diversify into consumer banking.

Although Wal-Mart regularly makes sizable acquisitions

abroad, it is in no position to respond in kind to such domestic dagger thrusts as CVS's \$26.5 billion acquisition of pharmacy benefits manager Caremark Rx. "That deal is a real threat, but Wal-Mart would have huge antitrust problems if it made an acquisition of any size," says a top mergers-and-acquisitions banker. "They are kind of stuck."

In the end, Wal-Mart seems unlikely to regain its stride unless it can solve what might be the diciest conundrum in retailing today. That is, can it seduce tens of millions of middle-income shoppers into stepping up their purchases in a major way without alienating its low-income legions in the process?

Largely because of the pressing need to differentiate itself from Wal-Mart, Target began grappling with this very puzzle more than a decade ago and gradually solved it with the cheap-chic panache that transformed it into "Tar-zhay." Says the president of a leading apparel maker: "Target has an awareness of what's happening in fashion equal to a luxury player, maybe greater. They have set the bar very high."

Scott acknowledged as much in making former Target exec Fleming chief marketing officer, reporting to Castro-Wright. Fleming, who had been CEO of Wal-Mart.com, went outside to fill every key slot in building a 40-person marketing group from scratch. He supported Wal-Mart's move into higher-priced, more fashionable apparel and home furnishings with the splashiest marketing the retailer had ever done, buying ad spreads in *Vogue* and sponsoring an open-air fashion show in Times Square.

Wal-Mart's top management all the way up to and including Scott presumed that Wal-Mart could run like Tar-zhay before it had learned to walk. "What Wal-Mart tried to do smacks of a kind of arrogant attitude toward fashion—that you can just order it, put it down, and people will buy it," says Eric Beder, a specialty retailing analyst at Brean Murray, Carret & Co.

CRASH COURSE

WAL-MART DID EVERYTHING at once and precipitously, introducing ads even as it was flooding stores with new merchandise and before it could complete its store remodeling program. Bentonville was learning marketing on the fly and did not even attempt to adopt the sort of formal, centralized merchandise planning at which Target and many big department-store chains excel. Instead, Wal-Mart relied on dozens of individual buyers to make critical decisions as it pushed hard into unfamiliar product areas.

How else to explain why a retailer whose typical female customer is thought to be a size 14 loaded up on skinny-leg jeans? Or why Wal-Mart's cheap-chic Metro7 line got off to a flying start in 350 stores only to crash and burn as it was rolled out to 1,150 more? Or why Wal-Mart not only severely misread demand for George-brand basics but also is unable to replenish its stocks for months on end while "fast-fashion" chains such as H&M easily turn over entire collections every six weeks?

Scott loved Wal-Mart's bold new direction until he hated it, his enthusiasm diminishing in sync with same-store sales throughout much of 2006. "We are going to sell for less," Scott says now, emphasizing a return to Wal-Mart's first principles. "I believe that long after we are gone, the person who sells for less will do more business than the person who doesn't."

Yet Scott also signaled his continuing commitment to the pursuit of the middle-income shopper by promoting Fleming to yet another new post, chief merchandising officer, as part of a January shakeup of the senior ranks. Although Wal-Mart

no doubt has sponsored its last glitzy runway show, Fleming insists that the company is sticking with its underlying strategy of "customer relevance" that is, of moving beyond a monolith focus on price to try to boost sales by targeting particular customers in new ways. "We're not going to back off," he vows. "We've learned certain lessons. Some things we'll build on, some things we won't."

While the look of its stores is primarily a function of how much Wal-Mart chooses to spend on them, the retailer is unlikely ever to come up with an ambience conducive to separating the affluent from their money without changing its whole approach to labor. The chain's dismal scores on customer satisfaction surveys imply that it is understaffing stores to the point where many of them struggle merely to meet the demands of its service format.

FLEMING The chief merchandising officer is the point man in Wal-Mart's pursuit of affluent shoppers

It is entirely possible even so that Wal-Mart in time will figure out how to sell vast quantities of dress-for-success blazers, 400-thread-count sheets, laptop computers, and even prepackaged sushi. But as Wal-Mart closes in on \$400 billion in annual revenues, it is going to have to overachieve just to get same-store sales rising again at 3% to 5% a year.

The odds are that Scott, or his successor, will have to choose between continuing to disappoint Wall Street or milking the U.S. operation for profits better reinvested overseas. Only hitting the business development equivalent of the lottery in countries like China, India, or Brazil can the world's largest retailer hope to restore the robust growth that once seemed like a birthright. ■

—With Mara Der Hovanesian, Lauren Yourison, and Pallavi Gogoi in New York



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Teaching the Body to Fix Itself

Cancer vaccines still in trial stages may be able to prolong life with few side effects, but the FDA has yet to be convinced

BY CATHERINE ARNST

BARBARA DERENOWSKI had just finished packing for a trip to Hawaii last May when she walked into her kitchen and found she was unable to speak. The 68-year-old retired nurse assumed she'd had a stroke, and she remained calm as her husband John drove her to the local hospital in Surprise, Ariz. There she got

the tragic news. Multiple brain scans revealed Barbara had the deadliest form of brain tumor, a glioblastoma, which kills most victims within a year. After undergoing surgery, Barbara was told she had about six months to live, and she knew from experience the doctor wasn't being overly negative. Her mother had died of a brain tumor at age 45, five months after the disease was diagnosed.

Beyond surgery, there are no effective treatments available for glioblasto-

mas. But Barbara's daughter, a TV news producer, knew about an experimental approach being tested at the University of Texas M.D. Anderson Cancer Center in Houston, a cancer vaccine designed to train the body's immune system to attack the tumor. It is different from Merck & Co.'s Gardasil vaccine, approved last year to block a virus that causes cervical cancer. M.D. Anderson's vaccine alerts the body's own defenses that cancer cells have taken root, essentially pro-

THE DERENOWSKIS A new drug may have halted the growth of Barbara's cancer

ding the body to heal itself.

Such therapeutic cancer vaccines have been the dream of oncologists for more than a century, but the theory, though elegant, has yet to prove itself. None of the dozens of vaccines in development has won approval from regulators, and there have been several high-profile failures in the past few years. One of the nation's leading cancer researchers, Dr. Steven A. Rosenberg of the National Cancer Institute, insists that "there are no therapeutic vaccines that have been shown to be effective."

It's true. There is no confirmation that vaccines can shrink tumors, a standard measure of a cancer drug's effectiveness. There are mounting signals these treatments can keep patients alive far longer than anyone thought possible without major side effects, but no data proving the point. What's more, researchers are not sure how to interpret the available survival data.

Many point out that there are no drugs known to prolong life without shrinking the tumor. But medicine is an uncertain science—and vaccine research is especially murky because much of the immune system's inner workings remain a enigma. A host of oncologists now agree that a treatment deserves serious consideration if it allows patients with no other alternatives to live longer, without impering their quality of life.

INCREASING EVIDENCE

THE EXPERIENCE OF Antigenics Inc. shows how this ambiguity plays out in the market and in patient care. Last year the company reported that its cancer vaccine, Oncophage, did not prevent recurrences of kidney cancer in a late-stage trial, a devastating blow to a drug some expected to win Food & Drug Administration approval this year. But on Apr. 1 researchers from the University of California at San Francisco reported that Oncophage produced a strong immune

reaction in all 12 glioblastoma patients in a clinical trial, and they were living on average four months longer than normal. Lead researcher Dr. Andrew Parsa, a neurosurgeon at UCSF, says the earlier Antigenic trial should be reconsidered: "There is no doubt in my mind there are kidney cancer patients alive because of that vaccine."

Like Parsa, scientists and companies in this field are beginning to sound less circumspect. The measured optimism is bolstered by sheer numbers: More than 60 vaccines are being tested in humans, and at least a dozen are in late-stage clinical trials (table, page 60). On Apr. 3, Cell Gene-sys Inc. reported that 22 patients taking its prostate cancer vaccine, GVAX, lived a median of 35 months after treatment, compared with 19 months on standard therapy. And an important milestone is looming: The FDA is slated to reach a decision by May 15 on the first therapeutic cancer vaccine up for approval, Dendreon Corp.'s Provenge, also for prostate cancer.

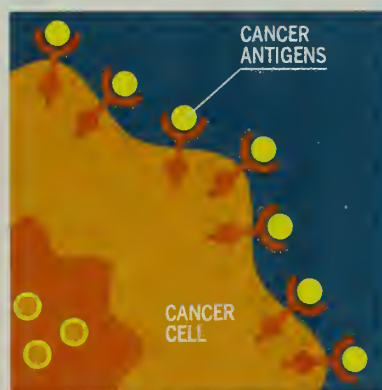
Barbara Derenowski is one of the patients raising the credibility of cancer vaccines. At M.D. Anderson she participated in a clinical trial of a vaccine developed by Celldex Therapeutics Inc. that is meant to seek out and destroy an aberrant bit of protein found only on cancer cells. She received her first shot in August, followed five days later by a large dose of chemotherapy, and has been going back for another injection every month since. "My latest MRI showed there was still no growth of any tumor," she says with obvious joy. "I can do just about everything I did before, though I still have a little trouble with my talking." "Everything" includes that

long-delayed trip to Hawaii. She and her husband are booked to leave in May.

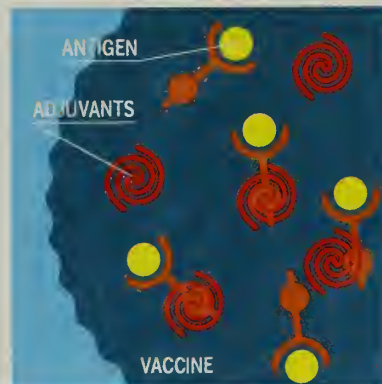
There are hundreds of patients like Derenowski, with a broad range of cancers, who say they owe their survival to a vaccine. They usually get through the treatment without the dire side effects linked to radia-

Attacking Tumors From Within

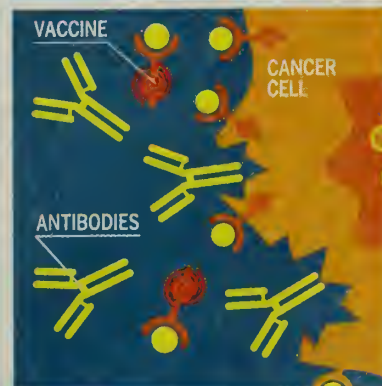
The body's immune system is primed to ward off foreign invaders such as viruses and bacteria, but unfortunately it ignores home-grown tumors. Therapeutic vaccines are designed to retrain immune cells to seek out and destroy the enemy within.



CANCER CELLS are essentially normal cells gone awry. As they mutate, they start sprouting bits of protein (antigens) on their surfaces that are unique to the tumor.



CANCER VACCINES are made by combining parts of cancer cells and/or their unique antigens with molecules called adjuvants that help boost the immune response.



SEVERAL WEEKS after the vaccine is injected into the patient, antibodies and other immune-system cells begin to attack cancer cells displaying the tumor-specific antigens.

tion and chemotherapy. As a result, analysts have come up with annual sales projections for this sector five years out ranging anywhere from \$600 million to \$6 billion.

But first, the drugs have to reach the market, and that will probably require data that show vaccines can extend life. Proving survival in the kind of large, lengthy, and well-designed clinical trial preferred by the FDA is challenging for the small biotech firms that dominate this field, although some are in the works. Cell Genesys is enrolling 1,200 patients in two Phase 3 clinical trials aimed at proving survival for its GVAX vaccine, but the results won't be in until 2009.

Meanwhile, the lack of such a trial for Dendreon's Provenge is causing a rift in the cancer community. A midstage trial of the vaccine in 127 patients with late-stage prostate cancer failed to reach its stated goal of slowing the disease's spread, usually a death knell for a new drug facing the FDA. But when Dendreon dug into the data it discovered patients on Provenge lived an average of 4½ months longer than those receiving the standard chemotherapy, Taxotere. To gain four months in such sick patients is considered significant, if it's real. But since the trial wasn't meant to prove survival, there is a chance something else could be prolonging these patients' lives. "This trial wasn't well-designed, so it leaves plenty of ambiguities," says Dr. Howard I. Scher, an expert in prostate cancer at Memorial Sloan-Kettering Cancer Center in New York. "It doesn't mean the drug isn't working, but it needs more study."

'A NEW FIELD'

SCHER WAS ONE of the naysayers on an FDA advisory panel that voted 13 to 4 on Mar. 28 to recommend approval of Provenge. He complains that the FDA may be lowering its standards for this drug. Others in the field insist vaccines are so novel and so well-tolerated that they must be evaluated by a different standard. (All 17 members of the FDA panel concluded that Provenge was safe.) "We are opening a new field," argued panel member Dr. Francesco Marincola, director of the Immunogenetics Laboratory at the National Institutes of Health. "There is much to learn by starting to see patients being treated with this."

The roots of this controversy lie in the immune system's strange relationship with cancer. Immune cells usually mount an inflammatory response the instant disease-causing invaders such as viruses or bacteria enter the body. Yet the body's sentries ignore mutant cancer cells, because they assume anything homegrown belongs in the body.

Therapeutic Vaccine Pipeline

While the FDA has yet to approve the first vaccine to treat cancer, many of these unusual treatments are now in clinical trials. Here are some promising contenders:

VACCINE/ COMPANY	TARGET	DEVELOPMENT STAGE	DESCRIPTION
PROVENGE Dendreon	Prostate cancer	FDA decision due by May 15	Immune structures called dendritic cells are isolated from patients and combined with an antigen found in 95% of prostate cancers
GVAX Cell Genesys	Prostate cancer	Company enrolling patients in two Phase 3 trials	Two genetically modified prostate tumor cell lines are combined with immune system boosters
MYVAX Genitope	Lymphoma	Phase 3 trial	Patient's cancer cells are combined with protein fragments from giant sea mollusks. Together they spark strong immune reaction
FAVID Faville	Lymphoma	Phase 3 trial, results expected second half 2007	Like Myvax, patient's unique cancer cells are combined with sea mollusk protein
TROVAX Oxford Biomedica/ Sanofi-Aventis	Kidney cancer	Phase 3 trial	Benign virus attached to a protein found in most solid tumors but not in normal cells
ONCOPHAGE Antigenics	Brain cancer	Phase 1 trial; earlier kidney cancer trial failed	Immune-stimulating "heat-shock" proteins are isolated from patient tumor

The idea that the immune system could be reprogrammed to fight cancer was first tested in the late 1800s by Dr. William B. Coley, a New York surgeon. He infected patients with a vaccine made from benign bacteria in an attempt to set off an anti-tumor response. Some patients experienced complete remissions, but the results were inconsistent and Coley's treatment never caught on.

A cancer vaccine renaissance started about a decade ago when a number of scientists and biotech firms came up with a better approach. They isolate various protein triggers found only on the surface of cancer cells. Technicians remove some of these proteins, or clone them in a lab, and combine them with various immune-system activators. That might be an inactive virus, or something altogether different. In the case of Genitope Corp.'s MyVax, a promising vaccine for lymphoma, the cancer protein is combined with a cloned piece of a giant sea mollusk, the keyhole limpet, which triggers a strong immune reaction because it is so alien to the human body.

So why, in trial after clinical trial, doesn't this reaction eliminate the tumor? Dr. Glenn Dranoff, a vaccine expert at Boston's Dana-Farber Cancer Institute, says there is

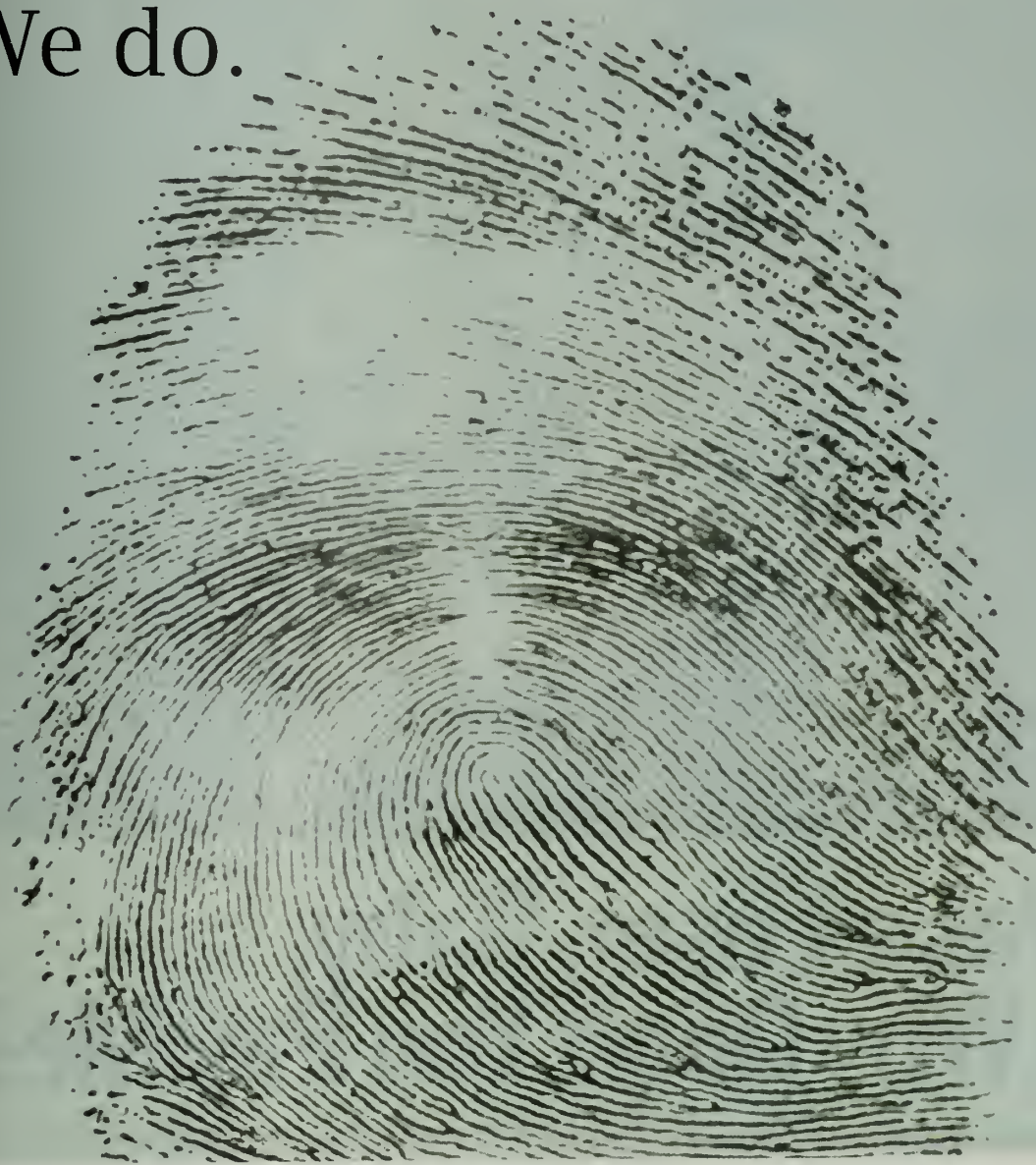
evidence immune cells infiltrate the tumor and kill it from within, leaving a ball of scar tissue the same size as the malignant growth. "You don't see a visible change in the size of the tumor, but the composition has been dramatically altered."

Oncologists believe vaccines will work best at stopping cancer recurrences after initial surgery. These metastases are what usually kill the patient. Consequently, a growing cadre of oncologists say patients who have failed other treatments should have a chance to try these drugs. Dr. Ivid F. Penson, a urologist at the University of Southern California's Norris Cancer Center who has consulted for Dendreon, is convinced Provenge has extended lives of his prostate cancer patients. He doesn't know what else could be doing it. Equally important, he says, is the quality-of-life issue. "These are guys who have one or two years to live, and their only treatment option is Taxotere," a chemotherapy so toxic that many men refuse treatment. With Provenge, "patients infused on Thursday and play golf on the weekend," says Penson. ■

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ONLINE: For a story on a Medarex drug that boosts cancer vaccines, go to www.businessweek.com/ext

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I Was a Loser, Baby, So Why Don't You Pay Me?

Bill Bartmann milks his losses on the motivational circuit

BY SUSAN BERFIELD

THE SECRET OF success is elegantly simple, like the law of gravity. This is how the world works: You need to be willing to take risks. You don't because you are afraid of failure; you are worried about what people will think. And that's because of low self-esteem. To succeed, you have to raise your self-esteem."

This is Bill Bartmann's come-on, his preamble, the most concise explanation he can offer for why he became a billionaire and those listening to him haven't even come close. On a Saturday in September, a couple dozen people, mostly entrepreneurs, of their own volition or at the urging of frustrated spouses and business partners, have paid \$49 to attend a daylong motivational seminar with Bartmann at the Reno-Sparks Convention Center in Nevada.

None are familiar with his name. Bartmann, 58, made (and lost) his fortune in the debt collection business, and both his rise and fall brought him national attention, if fleetingly. He was well-known in the financial world and in the business schools that studied his then-pioneering approaches to raising money; in Tulsa, where he was among the biggest employers; and in certain Las Vegas casinos, where he was a regular at the blackjack tables. But few of

“I’m selling the one thing everyone needs: self-confidence.”

—Bill Bartmann

...those circles would have followed tumultuous career.

Why am I an authority? Because I lived it. I’ve seen both sides of self-esteem. I went from poverty and welfare to being the 25th-wealthiest person in America. I went from being a high-school dropout to becoming a lawyer. I went from working at a traveling carnival to being named National Entrepreneur of the Year. I went from being a million dollars in debt to a billion dollars to the top. I learned how to change. I went through a significant, some say remarkable, transformation.”

Bill Bartmann’s career has been one of seized opportunities: oil in the 1980s, consumer debt in the 1990s, and now, in the age of Oprah, inspiration. Motivation, in all its guises, has become a \$10 billion industry even as its very premise—that its advice can change lives—remains unproven. Companies spend close to \$3 billion a year to hire people, among them former executives, sports coaches, and survivors of all kinds, to inspire and train employees; books ranging from *The*

7 Habits of Highly Effective People to *The Millionaire Next Door* are on *BusinessWeek*’s list of longtime best-sellers.

Richard, one of the main characters in the recent indie film hit *Little Miss Sunshine*, is a struggling motivational speaker. Michael Arndt, who wrote the movie’s screenplay, which won this year’s Academy Award, says: “Richard thinks he has a big idea that is going to transform his life. That’s a very American fantasy.” The success of motivational gurus such as Tony Robbins, Stephen R. Covey, and Zig Ziglar, all of whom have become multimillion-dollar brands, has helped promote the notion that selling inspiration can be a career choice. “If this becomes what I think it can, I’m back,” Bartmann says.

The tradition of teaching success goes back to Benjamin Franklin’s *Poor Richard’s Almanack* and runs through Dale Carnegie’s *How to Win Friends & Influence People* to Robert J. Ringer’s *Looking Out for #1*. The motivation business is sustained by a peculiarly American belief in reinvention combined with our nearly perpetual feelings of dissatisfaction. The big ideas, the supposed secrets of achievement, reflect and influence the cultural zeitgeist. Today those who have overcome adversity—they may be victims of disease, accidents, or their own daring or recklessness—have captured the national imagination. Such as: the guy who chopped off his arm to save his life (Aron Ralston); the woman who treated herself for breast cancer in the South Pole (Jerri Nielsen); the prison guy who became a top chef (Jeff Henderson).

In business, it is adversity of your own making that resonates today; learning from failure is an animating force for everything from innovation to ethics. “Redemption is big,” says Jonathan Black, author of *Yes You Can! Behind the Hype and Hustle of the Motivation Biz*. “But you have to admit you’ve failed. Otherwise people think you’re covering up.” One notable player on the failure circuit is Scott Waddle, commander of the nuclear submarine that accidentally sank a Japanese fishing boat in 2001, killing nine. Stripped of his command and retired, Waddle now earns \$10,000 a talk, the most popular of which is “Failure Is Not Final.”

By anyone’s estimation, Bill Bartmann’s life has been one of head-swalling highs and depressing lows. Bartmann made his first fortune running a company that manufactured oil pipes; the collapse of crude prices in 1985 left him without any customers and a million dollars in debt. A year later he had started Commercial Financial Services

Inc. with the notion that he might be able to squeeze money out of debtors everyone else had given up on.

In 1997, Bartmann and his wife, Kathy, who together owned 80% of CFS, made *Forbes*’ list of the 400 wealthiest Americans, a distinction Bill had long coveted. The magazine estimated the couple to be worth about \$1.1 billion. “We had lots of arguments about getting rich,” says Kathy. “I don’t care if I’m on any lists, if anyone knows me.” Bill worked in an office with a statue of Don Quixote, traveled with a security detail, didn’t join the country club as was expected, and generally annoyed the Tulsa business community with his swagger.

HITTING BOTTOM

BY THEN CFS HAD become the world’s largest holder of bad consumer debt; unlike its competitors it owned the debt outright and was trying to collect on some \$14.5 billion. A few skeptics wondered at the company’s rapid growth; by many accounts its revenues had doubled every year since 1994. When Goldman Sachs Group Inc. proposed taking the company public the summer of 1998, CFS was reckoned to be worth \$3 billion.

Four months later, credit agencies received an anonymous one-page letter accusing CFS of shady dealings. Bartmann would eventually be indicted on 57 federal counts of fraud, conspiracy, and money laundering related to an alleged scheme to make the company’s collection rate appear higher than it was. After an 89-day trial in 2003, he was acquitted of all the charges against him (his partner, Jay L. Jones, pleaded guilty to conspiracy and served 3½ years of a five-year prison term). It took Bartmann until 2006 to contend with various civil suits, and during that time he declared bankruptcy. He and Kathy had to give up 19 acres of their 20-acre estate. They lived off credit cards, borrowing from their two daughters when they had to.

Then Bartmann had his next big idea. As a businessman he had used the story of his early life to put lenders at ease, motivate employees, and in general establish his credibility as someone who can prosper in any circumstances. His setbacks began feeling like an affirmation of sorts: The wild arcs of his life offered valuable lessons. “I think I am the message, the answer,” he says. “I’m selling the one thing everyone needs: self-confidence.”

Successful motivational speakers require a measure of arrogance: They must believe they can compel an audience, essentially, to do their bidding. Bart-

mann's charisma is more closely related to cunning than magnetism. A 2001 *New Yorker* profile described him as having "an uncanny gift for making those who work for him feel that they share in his powers." A former senior executive at CFS, Wayne Learned, knows all about that. He actually invested in another doomed Bartmann enterprise after the CFS collapse, and depicts his former boss this way: "Persuasive isn't the right word to describe him. You do it to yourself as much as anything.... He'll call when he wants something and then he sucks you dry. You're like a raisin. When you work for him, you're his raisin."

What so mesmerizes people seems awkwardly exaggerated onstage in Reno. Bartmann's physical presence can be intimidating: He has a compact body, a rough voice, and an almost feral energy. His hands are those of someone who spent his adolescent years brawling. He wears a tight-fitting shirt and dark suit. He uses the language of the bill collector; he retains an outsider's posture.

SELLING, MODESTLY

IF ANYONE UNDERSTANDS the value of seeming authentic, it is Bill Bartmann. "Dogs know when you are afraid," he says. "People know when you're b.s.-ing them. You have to respect that."

Hence that afternoon's onstage pitch: "I'm awkward about this. I haven't set you up for the kill," he says. "I don't want to be a snake-oil salesman. I'm in the motivational, self-help industry. It's an industry that ranks right there with car salesmen. I don't know if I'm any better, any different, but I do know a few things.... Have I done a good job of un-selling?"

Bartmann carries around a laminated card in his pocket. On it is typed the following goal: touch 10 million people in five years. "It's a giant, crazy, ludicrous number," he says. "But if I touch enough people, the money should follow."

Bartmann started out using a classic motivational business model: sell tickets cheaply, give them away if necessary, and push packages of

DVDs and books (his is titled *Billionaire Secrets to Success*). In Reno, he sold several thousand dollars' worth. And he added 31 names to those already on his spreadsheet: nine million, nine hundred and eighty thousand and go.

Though there may be as many as 15,000 people trying to make a living as professional speakers, it is quite possible for the ones who catch on eventually to make a couple of million dollars a year. Bartmann, never one to shy from the grandiose, wants to make \$100 million. So in the weeks after Reno he began holding free two-hour seminars around the country as a way to advertise a yearlong mentoring program, conducted mostly over the phone and by e-mail at a cost of \$397 a month.

It hasn't escaped his attention that personal coaching has become a billion-dollar business itself. By December, he had visited seven cities and said he signed up 200 students. "If I don't make \$100 million a year from now, I'll be disappointed," he said then. He had other aims, too: "At 25 cities, I'll get a little plane. At 50 cities, a bigger one. I miss my G-IV. The plane is my measure of success. If I touch enough people to get a plane, I'll be a financial success."

Bartmann's problem, though, was that

success hinged on an admission of failure, which initially he was disinclined to make. That part of his story, he believed, couldn't so neatly be explained and wasn't appropriate at most of his seminars. "I don't amplify the CFS loss. It isn't inspirational," he said in September. "I say 'self-made billionaire.' I don't use the present tense. I know they can Google me and find out everything."

Then in March, Bartmann found himself in Hollywood where the idea of him hosting a "Dr. Failure" talk show somehow, wondrously, came up. By that time Bartmann was ready to tell his whole story. "I talk about CFS first. There is no more compelling story. Kathy said I should quit acting like I'm ashamed."

It makes everyone else's problems seem smaller. It gives them permission to tell me about their problems." He came with a new pitch: "To do for failure what Betty Ford did for alcoholism and Susan Komen did for breast cancer."

Bartmann has also made a decision that, in part, reflects his wish to be admired as well as recognized: All profit from his mentor program, for which he now charges \$797 a month, and his appearances at Get Motivated! Tours (where he is one of dozens alongside George Foreman and Zig Ziglar) and Learning

Annex Real Estate at Wealth Expos (where he is one of dozens alongside Donald Trump and Tony Robbins) will go into a foundation called Bill's Brigade. The foundation's aim is to gather 70,000 high school kids in the Texas Stadium in Dallas for a self-esteem revival meeting.

Bartmann hopes executive coaching, which will be his sole source of income, will pull \$100,000 a day. "I will do enough consulting that we will live well. Even the G-IV can't happen and I'm good with that. It would be a shame to make success a prior condition. There will be fewer heroes behind my name but it won't be bad. I moved from success to significance." ■

"It's an industry that ranks right there with car salesmen"

Motivation Inc. The top 10 brand names in the business

GURU	SALES 2005 (MIL.)	BEST KNOWN FOR
STEPHEN COVEY (FRANKLINCOVEY)	\$130*	<i>The 7 Habits of Highly Effective People</i>
TONY ROBBINS	\$45	<i>Personal Power</i>
DEEPAK CHOPRA	\$36	<i>The Seven Spiritual Laws of Success</i>
BRIAN TRACY	\$26	<i>The 21 Success Secrets of Self-Made Millionaires</i>
SUZE ORMAN	\$25	<i>The 9 Steps to Financial Freedom</i>
ZIG ZIGLAR	\$20	<i>See You at the Top</i>
TOM HOPKINS	\$20	<i>How to Master the Art of Selling</i>
PHILLIP MCGRAW	\$10+	<i>Life Strategies</i>
JACK CANFIELD AND MARK VICTOR HANSEN	\$10	<i>Chicken Soup for the Soul</i>
KEN BLANCHARD	\$3	<i>The One-Minute Manager</i>

*Sales from training and education division of FranklinCovey

Data: Estimates from Marketdata Enterprises Inc.

Under Armour May Be Overstretched

Why the sports apparel maker is one of the biggest shorts on the Street

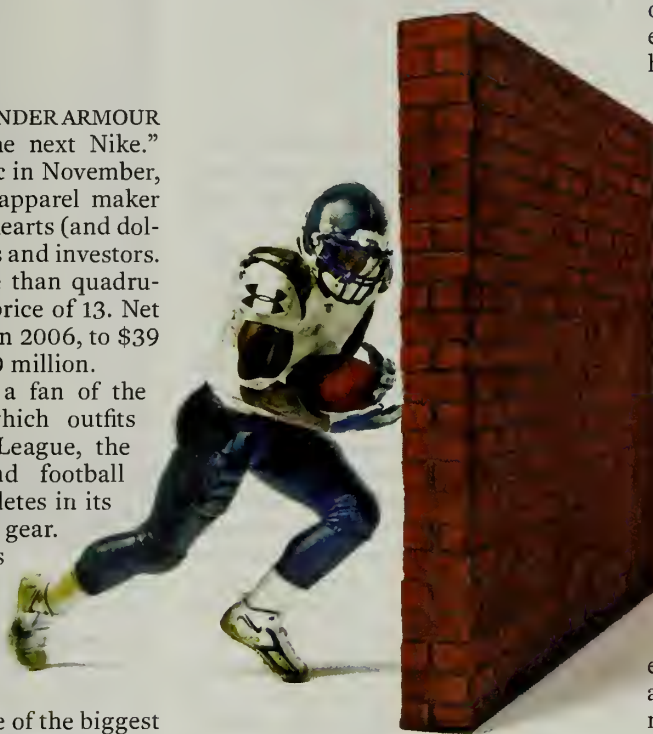
BY STANLEY HOLMES

IT'S NO WONDER UNDER ARMOUR is nicknamed "the next Nike." Since going public in November, 2005, the sports apparel maker has captured the hearts (and dollars) of consumers and investors. Shares have more than quadrupled from the offering price of 13. Net income nearly doubled in 2006, to \$39 million, on sales of \$430 million.

But not everyone is a fan of the Baltimore company, which outfits the National Football League, the University of Maryland football team, and other top athletes in its high-tech performance gear. Hedge funds and others betting the stock is headed for a fall: Some 7 million shares, or 2% of those available to the public, have been sold short, making it one of the biggest shorts on Wall Street.

The big worry is whether the company can keep growing at such a fast clip. Management, which declined to comment, figures it will continue to post earnings at a brisk 20% to 25% a year. But skeptics think the company's aggressive expansion plans and rich valuations make the stock vulnerable.

The company has made its fortune by exploiting the niches largely overlooked by the biggest names in sports stuff, a strategy that helped propel it to *BusinessWeek's* Fast Growth list of America's 100 fastest-growing companies in 2006. When founder and CEO Kevin A.



Plank started the business 11 years ago, he targeted professional athletes and serious fitness buffs, with a line of tight-fitting T-shirts made of a special material designed to keep active participants cool and dry during workouts and games. Under Armour now uses so-called syn-

thetic compression fabric in everything from running suits to yoga pants, a clothing franchise it's expanding overseas. Today the company commands a 75% share of the \$500 million performance apparel market, one of the fastest-growing and most profitable segments in sporting goods. "They have achieved great

success without having to seek out [big-name] professional endorsements, which cost a fortune," says Marie Driscoll, an analyst at Standard & Poor's. "The word of mouth is phenomenal."

Building off that brand recognition, Under Armour made its first foray into footwear in June, 2006, with cleats for football players, capturing 20% of the market in its first season. It followed with similar products for softball and baseball at the end of last year. Now management wants to push further afield. It plans to introduce a sports sneaker, like a running or cross-training shoe, by this fall or early 2008. Plank recently told investors he was preparing for such a launch by opening a manufacturing facility in China and beefing up its design and sourcing staff to increase its expertise outside of cleats.

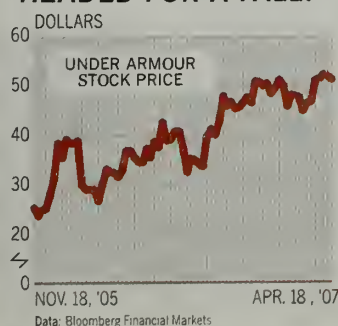
DENSE PACK

BUT MOVING into those areas means Under Armour will go head to head with the big boys, a major departure from its original blueprint for growth. The more mainstream footwear categories, unlike cleats, are already crowded with the likes of Nike, New Balance, and Adidas, among others. Those players will probably defend their turf aggressively, given the money at stake. While cleats represent just 1% of the \$12.3 billion athletic-footwear market, running shoes alone make up 40%. "They did extremely well in athletic-performance apparel because they were the first to market," says John Shanley, a retail analyst at Susquehanna Financial Group. "It's a different story with footwear."

Meanwhile, the competition is only heating up in Under Armour's mainstay, performance apparel. Starting in 2005, Nike launched a full frontal attack on Under Armour's stronghold. Morningstar Inc. stock analyst Brady Lemos estimates the behemoth spent \$30 million that year alone to aggressively promote its line of pro-quality gear.

The stock's high price only ups the ante for the company. At a recent 51, Under Armour sells for 65 times trailing earnings. That compares with the industry average of 19.5, which is about where Nike trades. Even during Nike's headiest growth days in the 1980s, it never traded hands for more than 25 times earnings. "[The high p-e] is causing some anxiety among investors," says Shanley. "Under Armour can't afford a misstep." ■

HEADED FOR A FALL?



That's Awfully Good Timing

The SEC takes a harder look at execs who may have backdated to cut their tax bills

BY JANE SASSEEN

FOR A FEW YEARS IN THE late 1990s, former E*Trade Group Chief Executive Christos M. Cotsakos epitomized a new breed of fast-moving entrepreneur who propelled the dot-com boom. Combining brash tactics with great business timing, his aggressive "Boot your broker" ad campaign not only made online trading hip but also established E*Trade as a major player.

Turns out that's not the only way Cotsakos demonstrated good timing. On six separate occasions between 1998 and 2002, Cotsakos exercised stock options when E*Trade hit a monthly low, and he held on to the shares. At first glance, that hardly seems lucky: Executives usually try to exercise options near stock highs to pocket the biggest profits. But going for low exercise prices and holding the stock for a while could have enabled Cotsakos to slash the tax bill owed when he sold the shares.

Now questions loom as to whether such impeccable timing reflects mere good luck or something more. The Securities & Exchange Commission has intensified a probe begun last fall into allegations that executives may have taken advantage of loose reporting rules in place before the Sarbanes-Oxley Act of 2002 to fudge the dates on which they exercised options. By doing so, executives may have changed stock-sale proceeds on which they owed ordinary income taxes into capital gains, which were taxed at roughly half the rate (table). SEC enforcement head Linda C. Thomsen has called

the practice, known as exercise backdating, "fraudulent," though in the one case that has come to court, the jury could not reach a verdict.

Amid the broader scandal over options grants, exercise backdating has gotten relatively little attention. But signs are mounting that it may have been prevalent during the boom. A recent SEC study found strong statistical evidence of exercise backdating over those years, while an examination by equity researchers Gradient Analytics Inc. found more than 500 companies—including PC maker Dell and satellite-TV provider EchoStar Communications—at which executives exercised

"It's not a random pattern," says one research firm

options on favorable dates. "It's not a random pattern we're seeing," says Gradient co-founder and finance professor Carr Bettis.

The lure was the difference between the tax rates on ordinary income and on capital gains. When executives exercise options, they usually sell the shares right away to lock in the gain between the option price and the current value;

any such gains realized are subject to ordinary income taxes. For top-bracket individuals, that meant Uncle Sam took a 39.6% cut each year between 1997 and 2000 and 39.1% in 2001. Those taxes are triggered when the options are exercised, regardless of whether the person sells the shares. But if someone exercised options and held the shares for at least a year, the gains realized after the exercise date would be taxed at the much lower capital-gains rate—just 20% between 1997 and 2002. Backdating accomplishes two things: It lowers the amount of taxes paid at the outset, and it potentially con-

verts some of the highly taxed income into more lightly taxed capital gains.

Exercise backdating could come back to bite companies suddenly forced to deal with correcting tax filings or restating their financial results. And for individuals, there's at least the possibility of criminal tax evasion and securities fraud charges if backdating is proven.

OPPORTUNE DELAY

BEFORE SARBANES-OXLEY took effect in August, 2002, executives didn't have to report their options exercises until the 10th day of the month following the transaction, so up to 40 days could pass

Stiffing Uncle Sam?

Before Sarbanes-Oxley, option exercise dates may have been manipulated to reduce tax liability. Here's how:



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between the reported exercise date and SEC filing. Executives may have been able to look back and choose an opportune date—when the stock traded higher—to report they had exercised options. The maximum gains that could be transformed from ordinary income to capital gains by the maneuver would be the difference between the value of the shares on the day the options were reportedly exercised and the date the transaction was filed with the SEC.

Bettis cautions that it's impossible to tell through public records alone precisely what happened with any individual trade. But in many cases, he believes, the trading

patterns ought to raise serious questions. Consider E*Trade's Cotsakos. He reported exercising options for 1.75 million split-adjusted shares on May 24, 2000; that day, the stock closed at 13.94 after plunging 32% in a week. By the time he filed with the SEC on June 5, shares had recovered 29%, to 17.94. According to Gradient, the stock's sharp rise during the timing lag could potentially have allowed Cotsakos to convert up to \$7 million in stock proceeds from ordinary income into capital gains. And that was hardly his only lucky moment: On five other dates, Cotsakos picked the lowest day of the reporting month to exercise options on a total of 2.6 million more shares. E*Trade says numerous documents support the reported exercise dates of the transactions. A spokesperson for Cotsakos, who left the company in 2003, denies any wrongdoing and says contemporaneous documents reviewed show no evidence of any "looking back" to a prior date.

Such cases were far more common before Sarbanes-Oxley took effect. SEC economist David C. Cicero recently analyzed exercises by 8,141 executives at more than 3,000 companies between 1996 and 2005. Before SarbOx, some 29% of executives held on to shares after exercising options, and those who did tended to exercise at clear troughs in the stock price. In the 10 days before an exercise, their shares fell an average of 1.93%; in the 20 days after exercise, their shares rose an average of 4.72%.

RED FLAGS

THAT CONTRASTS SHARPLY with executives who sold shares right away; they tended to exercise near stock highs. And according to the study, the trough disappeared after SarbOx as executives had to start reporting stock transactions within two business days. Roughly 12% of such options exercises took place at the lowest price of the month pre-SarbOx; after SarbOx, that figure dropped to 6.9%.

Another red flag in the study: Returns tended to be higher when more than one executive exercised options without selling shares on the same day, a pattern Gradient

also found. Two Dell executives, for example, appear to have made well-timed exercises on June 1, 1998: Then-Chief Financial Officer Thomas J. Meredith exercised options for 320,000 split-adjusted shares, while Vice-Chairman Morton L. Topfer exercised 2.24 million options on a day when Dell shares hit 19.58 after a two-week slide. By the time the pair filed with the SEC on July 10, the stock had jumped above 25. For Topfer, the difference meant up to \$12.6 million in gains may have become eligible for capital-gains treatment, while for Meredith, gains of up to \$1.8 million might have gained the more beneficial rate. He exercised another 320,000 options on June 1, 1999, as shares hit an annual low of 33.06. By the time he reported it, on July 9, shares were up 29%. The potential benefit: up to \$3.1 million in proceeds shifted to capital gains. Topfer has since left Dell and declined to comment. Meredith, who became acting CFO of Motorola Inc. on Apr. 1, was unavailable for comment. Dell says it's confident the transactions occurred on the dates reported.

Charles W. Ergen, the founder and CEO of EchoStar, has benefited from well-timed trades, too. He reported exercising options for 428,704 split-adjusted shares on May 5, 1999, after shares fell 22% to bottom out at 11.06. By the time the SEC report was filed on June 10, shares had soared more than 50%. According to Gradient, up to \$2.4 million may have been considered capital gains instead of ordinary income. Meanwhile, EchoStar's general counsel, David K. Moskowitz, reported exercising a combined 447,490 options on Dec. 1, 1999, and Jan. 6, 2000; both dates fell on the stock's monthly low. By the time they were reported, roughly five weeks later, the potential benefit was as much as \$1.98 million in income transformed into capital gains. Neither Ergen nor Moskowitz were made available for comment. Robert F. Rehg, EchoStar senior vice-president, says some options were about to expire and had to be exercised, and adds that the company's records show all transactions were executed properly. ■

Imagine that shares of Company X bottomed out at \$20 on May 12, 1999. On June 10, with the stock back up to \$30, an executive exercises options for 10,000 shares at a strike price of \$5. He pays \$2.5 million for the shares and sells them for \$14 million. His profit: \$11.5 million. At the top ordinary income rate of 39.6%, he'd owe Uncle Sam \$4.6 million.

» Now imagine that on June 10 he decides to **backdate** and hold on to the shares for a year. He files an **SEC report** saying he exercised the options back on May 12 at \$20. He still pays \$2.5 million, but receives shares worth only \$10 million. Therefore the gain on which he pays ordinary income tax is now just \$7.5 million. He owes Uncle Sam \$3 million.

» When he sells the shares after a year, the difference in their value between May 12 and June 10—\$4 million—is taxed at the 20% **capital-gains rate**. Uncle Sam gets just \$800,000 on the \$4 million.

» In the end, by backdating the exercise date of the options, the executive **cut his tax bill** for the period from \$4.6 million to \$3.8 million.

A Radar Screen for E-biz

Little Omniture's software is helping biggies like Toyota and Microsoft track Web performance, but rivals are hot on its heels



SITTING PRETTY
CEO James in
Omniture's Orem
(Utah) headquarters

BY SPENCER E. ANTE

IT WAS A FEW MINUTES BEFORE 4 p.m. in New York City, and Joshua G. James was ready for his close-up. The chief executive of Omniture Inc. stood on stage at the NASDAQ broadcast studio, smack in the middle of Times Square, ready to play the starring role in a hoary Wall Street ritual: ringing the closing bell.

James had been invited to close the NASDAQ on this bone-chilling day in mid-February because he is the leader of the fastest-growing publicly traded software company and because Omniture has pulled off one of the most successful tech stock offerings in recent memory. After going public last June at 6.50, Omniture shares recently passed 100, giving the company a market capitalization of close to \$1 billion and making James worth, at least on paper, about \$100 million.

It's a classic Silicon Valley tale: Young entrepreneur cashes in via public offering. Except that the 33-year-old James and his startup sprang out of nowhere—or Orem, Utah, to be exact. “If Josh had been in Silicon Valley, he would have already been a rock star,” says Mark P. Gorenberg, a partner in venture capital firm Hummer Winblad Venture Partners in San Francisco, whose 15% stake in the company produced the best return in the firm's history. “Being out here, he was an undiscovered gem.”

Against all odds, tiny Omniture, with 2006 sales of just \$80 million, has installed its software onto the computers of more than 2,000 of the world's major corporations, the likes of Microsoft, Wal-Mart, Hyatt, Toyota, and The McGraw-Hill Companies, owner of *BusinessWeek*. Its desktop readouts :

INNOVATION
CASE STUDY



> > >



an cheese makers take pride in Parmigiano Reggiano, a cheese so distinctive that law dictates it come only from select provinces of Italy. Parmigiano Reggiano cheese makers wanted more productivity while maintaining this legendary quality. Cargill brought animal nutrition experts into the process who understood dairy cow productivity. They developed special feeds to supplement the cows' base diet of natural grasses and hay. Now the cows give milk that generates better yields of high-quality Parmigiano Reggiano. And there's more of the aged cheese for all to enjoy. This is how Cargill works with customers.

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like the instrument panel on a jet plane. But instead of tracking air speed they monitor the velocity of Web marketing tools such as e-mails, search engine keywords, and display advertising. With huge chunks of advertising shifting to the Web from traditional media, Omniture has emerged as a key player in the digital economy. "This is vital to us," says Johanna Steen, MSNBC.com's manager of marketing research and a user of the software. "It's the difference between taking a road trip following your instincts and taking a road trip with a map."

Now that they've established the value of so-called Web optimization programs, though, this tech entrepreneur and his company will have to withstand an onslaught of competition, ranging from more than a dozen startups to that Internet gorilla, Google Inc., which offers a simpler analytics program that has the advantage of being free.

HEAVY TRAFFIC

JAMES AND HIS co-founder, John Pestana, followed a roundabout path to their breakthrough. Both dropped out of Brigham Young University in 1996 to launch a company, but they experimented with several business models before hitting upon the current incarnation. First they developed Web sites for companies, then they started an advertiser-supported analytics program. Finally in 2002 they created Omniture to focus on leasing their technology to large customers.

For publishers, optimization means increasing the amount of traffic on their Web sites. Take Andrew Wilson, the general manager of new media for the Meredith Corp., a big magazine publisher with titles such as *Better Homes and Gardens* and *Ladies' Home Journal*. Last year, Wilson used Omniture's programs to test out an important new product, Meredith's first paid online service, *Decorating Inspiration*. Through the *Better Homes and Gardens* Web site, *Decorating Inspiration* lets homeowners view more than 15,000 photos that show them ideas for sprucing up kitchens and bathrooms, and other home renovation projects.

Revving up the Web

Here's how some companies are using Omniture's software to improve the performance of their sites, e-mail newsletters, banner ads, and search engine keywords:



E-COMMERCE EBags, an online luggage retailer, conducted a test of two microsites that sold computer laptop cases. After learning that one microsite generated 30% more revenue than the other, the company switched all of its links to the higher-performing site.



SEARCH ENGINE MARKETING Hyatt once used an outside ad agency to manage its search engine keyword campaigns. Now the company saves money by having its own employees manage campaigns, and it can measure the rate at which certain keywords lead to sales.



WEB METRICS After finding out just how popular slide shows were with online readers, MSNBC.com developed a "related photos" feature that lets them view other photos in its database. It generated 150 million page views in the past year.

Wilson needed to determine how best to sell the service, though. So he created one Web site with an animated tour of the service, and another site that gave consumers a free preview. With the Omniture tools, Wilson could quickly determine that the two sites generated very different results. Visitors who came from search engines such as Google or Yahoo! preferred the free preview. Even better, the software revealed that the preview page produced three times as much revenue from users who signed up for the service. Wilson shut down the animated site and redirected consumers to the more productive one. "We were able to make our search advertisements really profitable," says Wilson.

But Omniture's innovation doesn't stop with its tools. It manages all the data and software on its 8,000 computer servers, a model that boosts revenues. Typically, customers subscribe to the service for a few years with minimum usage levels based on monthly page views or transactions. If they exceed the minimum usage, they pay more. When a user clicks on a link or buys something online, the data flow to one of Omniture's servers, where they get processed and served

up in digestible form on a browser.

That way, a mountain of data is converted into useful nuggets. A year ago Hyatt Hotels & Resorts was using an online ad agency to manage the 70,000 keywords that the chain bids on each day from Web search engines, and had to use several programs to analyze the results. Omniture gives Hyatt a place where it can internally manage all of its keyword campaigns. Hyatt previously could only see the rate at which customers clicked on a search advertisement; now Omniture shows the conversion rate, or number of consumers who actually make a purchase based on a search ad. "It has dramatically changed the funding for each of the keywords and categories we buy," says Hyatt's director of e-commerce, Greg Johnston. "We are saving hundreds of thousands of dollars."

SPEND, SPEND, SPEND

THAT'S FUELING Google-like growth, albeit from a far smaller base. In 2006, Omniture sales shot up 86%, compared with 73% for Google; this year, analysts expect Omniture to grow 66%, to \$1.1 billion. It's still losing money—analysts expect a net loss of \$13 million this year. A big reason for that is high sales and marketing costs, which came to 43% of sales in 2006. That's OACR for now, figures Credit Suisse Group analyst Jason Maynard, since Omniture should snap up as much of the market as it can. He has an "outperform" rating on the stock.

But the clock is ticking. "If they don't make progress toward their performance targets in the second half of the year, it could be cause for concern," says Renaissance Capital analyst Phil Stoller. And there's always the chance that Google will get more aggressive about Web optimization. "If we're not scared of them, something would be wrong with us," says James.

Still, he feels up to the challenge. His mother, Kandi, who was in the crowd at the NASDAQ ceremony, notes that since he was young, James has always been a self-starter. "Most mothers have to push their kids" to become Eagle Scouts. "I didn't care. He got his Eagle by himself." A short while later, Omniture had its 15 minutes of fame. James closed the market and an image of his team flashed on a screen in Times Square. James was jazzed, but quickly noted the work ahead: His goal, he said, is to "create a billion-dollar software company." ■

HP Sees a Gold Mine in Data Mining

CEO Hurd is leading the company's battle against his old employer, NCR

LOUISE LEE

IT WAS AN AWKWARD SITUATION for Mark V. Hurd. Last summer, Hewlett-Packard Co. began quietly promoting Neoview, a data-mining technology aimed at big corporations that's key to its growth plan. But Hurd, 15 months into his tenure as HP's chief executive, didn't get out and sell Neoview like the company's other products.

That's because Neoview pushes HP into the turf of Hurd's old employer, NCR. Hurd headed up NCR's Teradata business as recently as 2002, then ran all of NCR before jumping to the top job at HP in March, 2005. Even after his non-compete agreement expired in September, Hurd waited another four months before easing into personally trying to sell Neoview. As HP's corporate-products group Executive Vice-President Ann M. Larmore delicately put it, that delay was "to allow enough time and separation from his previous employer." It didn't seem like a great idea to push a data-crunching product just as HP was knee-deep in its scandal over snooping reporters and board members.

Starting on Apr. 24, though, HP will be going all out to formally launch Neoview. The system, which costs from \$600,000 to over \$15 million, depending on the size of the setup, consists of a combination of HP servers, database machines, and software that helps companies mine and organize huge banks of data.

His near-instantaneous number-crunching, known as data warehousing, is the green hand that allows all manner of everyday decisions: the airline rep pulling out how many miles you've



flown to determine whether to give you a seat on an overbooked flight, or the grocer discovering a link between sales of pretzels and sales of small plastic bags handy for packing snacks, and stocking shelves accordingly.

With sales of \$92 billion last year, HP nudged past IBM as the world's largest high-tech company. But to meet Hurd's goal of 4% to 6% revenue growth, HP needs to locate at least \$3.7 billion in additional sales. Hurd has been snapping up software companies and investing in the data business. A year ago he created a separate research group to solve some of the issues that keep chief information officers awake at night. HP also is adding salespeople to focus on sell-

ing data-warehousing systems, hiring talent from Teradata as well as from IBM and other software-consulting firms.

Teradata is the market leader and expects to boost its \$1.5 billion revenues by 7% to 9% this year. But the top brass there don't sound worried about Hurd's push into their territory. "We've got the best customers. Every year is a record year," says Robert E. Fair Jr., Teradata's chief marketing officer. Says analyst Stuart Williams at Technology Business Research Inc. in Hampton, N.H.: "HP has the challenge of gaining recognition."

NCR expects to spin off Teradata, which had 2005 operating profits of \$340 million, to its shareholders later this year. But when Hurd took over Teradata, NCR was a fading company best known for cash registers and automated-teller machines. His team latched onto the need to pull together and analyze large pools of data that lie scattered among many dissimilar computer systems.

Consolidating data onto a single large system can lend a vital advantage. The more complete the body of information you can mine, the better and faster you can make decisions. One example: Merchants at any of the 279 Bon-Ton department stores already tap into Neoview to analyze merchandise sales by supplier. That helps them see precisely which vendor's products are selling and when,

and better plan buying decisions. Hunger for those insights is driving a boom in big data warehouses. A survey of 479 companies last fall by researcher IDC found the vast majority of respondents expected their largest data facility to grow within 12 months; 18% expected a doubling and 42% projected a 25% to 50% boost.

HP is now in full-blown sales mode with Neoview. And it's rolling out the heavy guns. CIO Randy Mott, legendary in tech circles for his successful implementation of data systems at Wal-Mart Stores and Dell, is available to chat. And if need be, Hurd—now free of any conflicts—is ready to step in to help close the deal. ■

VISIONARY Hurd was the driving force behind Teradata, NCR's market leader

Neoview setups will bring HP \$600,000 to \$15 million each

Creating a Better Life for the Business Traveler

It's often rough going for business travelers. Planes are full, delays are plentiful, hassles are frequent. When Orbitz for Business conducted a poll recently, it found that business travelers consider life on the road more difficult than it was two years ago. Flight delays and cancellations were cited as the biggest pet peeves, followed by security lines and draconian carry-on restrictions.

But there's plenty of good news for road warriors, too. Once you take off, there are new ways airlines have improved in-flight service. **Korean Air Lines** has won several important reader-choice awards for its roomy sleeper seats, and superb on-demand in-flight entertainment system.

Lufthansa (www.lufthansa.com), which recently enhanced its premium-class service, has redefined long-haul flight comfort. Thanks to retractable armrests, business-class passengers have ample room for arms and shoulders; then at the push of a button, the seat morphs into a cushy, six-foot PrivateBed, complete with massage function. If you need to work, a large worktable, storage space for laptop and files, power connection and individual reading light are all integrated into your space.

And when it's time to dine, you'll do it in style. The airline has partnered with Peninsula Hotels, whose chefs and sommeliers have created special menus for the Connoisseurs on Board food and wine program offered to first- and business-class passengers.

Being one of the early pioneers of the all-business-class product, Lufthansa knows all about Business Class. Besides offering three business-class only routes between North America and Europe, they also offer Private Jet service for customers booking private air travel in conjunction with scheduled commercial flights.

Airport lounges are homing in on frequent travelers as well. **Cathay Pacific Airways** gets special recognition for its private cabanas (with soaking tubs) at its hub, Hong Kong International Airport; **Malaysia Airlines** wins kudos for its fantastical lounge at Kuala Lumpur International Airport. It's the only one in the world with a river running through it.

As the world continues to globalize, the demand for these services will likely grow, even for companies keeping a gimlet eye on costs. NBTA president and CEO, Suzanne Fletcher, said, "While most companies have tightened policies regarding

first- and business-class travel in the last 10 years, some have begun shifting policy to allow more travelers to fly Business Class on long-haul flights."

How's this for another convenient touch? A way to keep fit without having to go to a fitness center. **Omni Hotels** will hand you a Get Fit Kit when you check in. The contents: barbell, resistance band, yoga mat and radio with ear buds.

And finally, tired of the stress of being lost and late in a strange city? When you want to navigate like a native, bring along an ultra-portable GPS navigation/mapping unit like the compact, easy to use **Garmin nüvi™ 350** and you'll never have to make any more U-turns. It's a versatile travel assistant about the size of a deck of cards.

MAXIMIZE THE VALUE OF TRAVEL PROGRAMS WITH THE NATIONAL BUSINESS TRAVEL ASSOCIATION (NBTA)



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NBTA is the voice of business travel in Washington, lobbying for policies that benefit business travelers and their companies.

The NBTA International Convention & Exposition - held this year in Boston, July 22-25 - is the largest gathering of travel vendors and corporate managers in the world. With nearly 6,000 attendees expected this year, it is the must-attend event for business travel professionals. NBTA also offers networking and education events in Brazil, China, England, and Mexico. For more information, visit www.nbta.org.

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Design: Sundberg & Associates Inc., New York City

Produced by: Meigs Media Group, Inc., Stanfordville, NY E-mail: jon@meigsmedia.com



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COMMENTARY

BY JOHN CAREY

Ethanol Is Not the Only Green in Town

Memo to Feds: Make subsidies available to the whole field of biofuel innovation

IF JOHN G. MELO IS RIGHT, AMERICA'S fuel policy is heading down the wrong road. Melo is chief executive of Amyris Biotechnologies in Emeryville, Calif. The startup adds genes to microbes so the bugs convert sugar into useful stuff—such as green fuels. Amyris figures it can make a diesel and a gasoline-like product that offer major advantages over ethanol and biodiesel, today's alter-

native-fuel darlings. "Why not look for better solutions?" says Melo. "There is a second generation of fuels coming that could be very helpful to the country."

But not with the current mix of energy subsidies. Thanks to years of lobbying by ethanol and biodiesel producers, those two fuels get the big breaks. A number of states mandate that ethanol or biodiesel be blended with oil-based fuels, and Congress has locked in tax subsidies of 51¢ per gallon of ethanol and \$1 per gallon of biodiesel. The laws also narrowly define biodiesel in terms of a specific process, shutting out innovations and improvements.

Which leaves out not just Amyris but others working on better green fuels. DuPont and BP PLC have a joint venture to make bio-butanol, a relative of ethanol, while startup LS9 Inc. mimics an ingredient in gasoline. State and federal rules create hurdles for both approaches. "Policies should not discourage new technologies," says Louis Burke, manager of alternative energy and programs at ConocoPhillips.

There are legitimate arguments about whether subsidies are needed at all, but with the White House and Congress rushing to promote alternatives to fossil fuels, incentives are almost inevitable. So the subsidies need to be smarter. "We need a level playing field for all the processes," says Henrik Erametsa, president of the U.S. subsidiary of Finland's Neste Oil, which has a new plant making renewable diesel—not classed as biodiesel—from animal fat.

Both ethanol and biodiesel have problems. Biodiesel goes rancid and can freeze, making it hard to start cars in the winter. Ethanol can't be used in high concentrations in existing pipelines and pumps. It also contains about 30% less energy than gasoline, causing mileage to drop. The rush to make ethanol from corn has already doubled corn prices and raised food prices. And it does little to slow global warming. "From an environmental standpoint, ethanol is a deal with the devil," says Amyris marketing vice-president Rahul Shendure.

CONOCO'S BIG FAT CREDIT

SO WHEN DUPONT DECIDED to get into the biofuel game, "we sat down with BP and asked what was better," says John Pierce, DuPont vice president for bio-based technology. The two companies picked butanol, which has more energy per gallon than ethanol and is compatible with today's pipelines and pumps. So are the fuels from startups like Amyris, Gevo, and LS9. "In the circles we move in, no one thinks we'll still be using ethanol in 25 years," says Stanford biologist Chris Somerville.

Companies will invest big bucks once the subsidies are no longer tilted. ConocoPhillips and others fought with the National Biodiesel Board over whether fats turned into fuel with heat and catalysts also qualify for the green diesel credit. In early April, the IRS ruled in favor of Conoco. Two weeks later, Conoco and Tyson Foods Inc. announced plans to refine diesel from leftover poultry, pork, and beef fat. In addition to offering a better fuel than biodiesel, the operation will be a boon to livestock producers hurt by ethanol-boosted corn prices. "It's a technology that turns the waste products into fuel," says Conoco's Burke.

Ethanol and biodiesel aren't bad. Added to petroleum-based fuels, they are cutting oil use and paving the way for renewables. But Congress should avoid locking in specific fuels, by applying any subsidies equally to all contenders. "It is likely that we will end up with better fuels," says venture capitalist Vinod Khosla, who is backing Amyris and others. "That is what innovation is all about."



"Fat" diesel is better fuel and a boon to livestock producers

BusinessWeek .com

ONLINE: To watch a video report on biodiesel vehicles, go to www.businessweek.com/go/tv/biodiesel

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Avicena recently announced initiation of a Phase III trial for Parkinson's Disease and plans to initiate a Phase III trial for Huntington's early next year. In addition, Avicena is currently analyzing data from its Phase IIb/III trial in ALS (Amyotrophic Lateral Sclerosis, or Lou Gehrig's disease). Unlike traditional biotechnology companies, Avicena's clinical programs are largely funded by government and non-profit organizations. Avicena presently derives revenue from the sale of proprietary pharmaceutical ingredients to skin care manufacturers.

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Who's Afraid of A Housing Slump?

Not Sherwin-Williams. Despite downturns, the paint giant hasn't had a loss since 1977

BY MICHAEL ARNDT

SHERWIN-WILLIAMS DAZZLES customers with 1,511 paint hues, from "quaint peche" to "rapture blue." But with housing starts projected to plunge at least 20% in 2007, after dropping 13% in 2006, and spending on home remodeling expected to grow by half of last year's 8% increase, you'd think a new color might have to be added to its palette: bottom-line red. The company, after all, makes most of its money by selling paint to builders and do-it-yourselfers through its own chain of 3,000 stores and home-improvement retailers such as Home Depot Inc.

But Chairman and CEO Christopher M. Connor is far from downbeat on his company's prospects. Connor, 51, predicts another record year, with revenue rising 5% or so, to \$8.2 billion, and net income up as much as 10%, to \$633 million. The key is the company's geographic and market diversity, which helps mute the impact of a downturn in any one sector or country. "Clearly, we're going to have headwinds," says Connor. "I won't be cavalier. But we've been through housing downturns many times."

Yes, Sherwin-Williams has. The company, which made its debut at 22 on this year's BusinessWeek 50 list of best-performing companies, dates to 1866, when Henry Sherwin spent \$2,000 to begin an industrial-goods distributorship. Edward Williams joined four years later. Today the Cleveland-based company has 30,800 employees and operations in 14 countries. Despite repeated down cycles in housing, it hasn't had a loss since 1977 and has boosted its dividend every year since 1979.



Sherwin-Williams Co., owner of the Dutch Boy, Pratt & Lambert, Krylon, and Minwax brands, has a long history of spreading its bets. That falloff in housing starts? It turns out that just 16%

of wall-and-ceiling paint sales comes from new-home builders. And sales in other markets, such as commercial construction, are still on the upswing. The company's \$600 million automotive-paint division, a steady and higher-margin business that sells primarily to car-repair shops, is also growing fast in the U.S.—and even faster in Latin America. In addition, Sherwin-Williams has gallons of cash for acquisitions and

retail expansion, which could push share of the U.S. paint market beyond its current 40%.

RETAIL EXPANSION

UNDER CONNOR, a 24-year company veteran who became CEO in 1994, Sherwin-Williams has been particular about how it spends money. Until last year, when the company opened a paint plant in Fernley, Nev., it had gone 10 years without a new factory. Less than 0.5% of sales is devoted to research and development. Instead, the company uses its bankroll to snap up smaller rivals, such as Duron Inc., which it bought in 2004 for \$253 million.

Unlike most of its competitors, Sherwin-Williams is more than a manufacturer. It added 117 stores worldwide in 2006 and plans to open at least 100 more this year, with the goal of eventually hitting 4,000. Having its own stores means the company doesn't have to rely on other retailers to sell its products or offer them incentives for prime shelf space. It also allows Sherwin-Williams to go beyond individual shoppers, who are increasingly anxious about house prices, and deal directly with contractors.

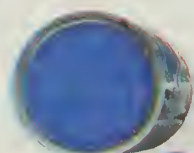
Connor is now taking this strategy abroad. While Sherwin-Williams has long had outlets in Latin America selling automotive paints, it announced on Apr. 4 that it has entered India's residential paint market with the purchase of Nitco Paints in Mumbai. Any expansion shouldn't strain its pocketbook: Thanks to strong cash flow and a pause in making big acquisitions, the company entered 2007 with \$469.2 million in cash, \$36 million a year ago.

A small step into the huge Indian market isn't enough to keep analysts bullish on the company. Since last July, every rating change has been a downgrade, and analysts watch the stock surging target prices. In

Wall Street's worries don't seem to be rattling many investors. Although Sherwin-Williams' stock is off its February time high of 70.95, shares closed at 64.86 on Apr. 17. That's still almost double the price three years ago. Given the company's track record, it sounds like Sherwin-Williams' "halcyon green" and "believable buff" may be the big colors for 2007. ■

Glossy Gains

Sherwin-Williams' stock price has nearly doubled in three years



Data: Bloomberg Financial Markets



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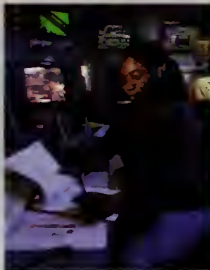
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Washington Group International (NYSE: WNG), headquartered in Boise, Idaho, is a global engineering, construction, and management company with 25,000 employees worldwide and more than \$3 billion in annual revenue. Over the last four years, the company's net income has climbed by a compound annual growth rate of 39%. Since January 2002 its stock price has increased more than 20% annually, compared to the S&P 500's 6% average. The company has \$9.5 billion in "work to complete" on existing contracts and continues to sign major new work—from power to industrial processing to mining.

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- Cleaning up the environment and destroying weapons of mass destruction internationally, including 78% of the aging U.S. chemical weapons stockpile.

FOCUSING ON PEOPLE

These accomplishments have come about through skillful management and exceptional customer service, of course. But the most important factor, say Washington Group International executives, is the company's intense focus on the careers and capabilities of its people.

"My commitment is that the best career opportunities in the industry will be found at Washington Group International," says Chief Executive Officer Stephen G. Hanks. "The talent of our 25,000 employees around the world and our extensive

efforts in employee development truly set Washington Group International apart. Even more importantly, it produces superior performance for our customers and stockholders."

Such efforts are clearly paying off. Among its honors, the company was named by global human resources firm Hewitt Associates as one of the Top 20 Companies for Leaders.

A COMMITMENT TO SAFETY

At the same time, Washington Group International has repeatedly been recognized as one of the safest companies in the world, despite the challenging work it undertakes. For example, the company's "days away from work cases" are a fraction of the figures posted not only by the U.S. engineering and construction industry overall, but also by presumably "safe" industries like museums, retailers, and florists.

"Safety is of paramount importance to our customers," says Mr. Hanks. "Whether we are meeting with a large industrial company, the U.S. Departments of Defense or Energy, or state transportation agencies, invariably the first question we are asked is about safety. Potential clients are obviously focused on finishing projects on time and under budget, but more than anything, they want to make sure the work is completed safely."

It is a result that Washington Group International invariably delivers, as evidenced by its leading safety record, superior financial results, and the fact that about 75% of its new work comes from repeat customers.

TALENT, ETHICS, AND PROFESSIONALISM

"We couldn't be more proud of the people who work at Washington Group International," concludes Mr. Hanks. "Their talent, ethics, and professionalism are the reason for our success—from our double-digit earnings growth to our industry-leading performance and safety records."

It is this sense of pride and vision that also prompted Washington Group to join the New York Stock Exchange (NYSE) in March. "The NYSE is the 'Big Board,'" says Mr. Hanks. "It's where most of our private-sector customers are. And it's where a company of our stature and commitment to its customers belongs."

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PLAY, BARKEEP Hagar talks up his tequila in interviews and on stage with his band



Tequila with a Rock 'n' Roll Chaser

How Sammy Hagar took Cabo Wabo from a vanity hangout to a \$60 million business

BY STACY PERMAN

BACK WHEN CABO SAN Lucas was an overlooked Mexican seaside village, rocker Sammy Hagar would visit and joke that the drunks wobbling down the dirt roads were doing "the Cabo Wabo." Hagar, the former lead singer for Van Halen, admits his early days of tequila drinking weren't pretty either. But in 1982 he tasted the good stuff—premium blanco tequila. "It changed my life. I became a blanco freak," says Hagar.

That enthusiasm led him to open a cantina where he could eat, drink, and play music. "It was just an ego trip," he says. "The town wasn't even big enough to accommodate the idea." But in the late nineties, Cabo became a stop on the cruise-ship circuit. The roads were paved, and Iggy Pop, U2,

and Guns N' Roses flew down to the cantina for gigs. Today the Red Rocker is front man for Cabo Wabo Enterprises, a \$60 million company in Novato, Calif., with a line of premium tequilas and a chain of tequila bars.

As an entrepreneur, Hagar says he plays by the same rules that brought him fame in the music business. No. 1: follow his gut. "Before I made it as a rocker, I had a lot of executives tell me what to do to make it, and I never listened to them," he says. "I did it my way."

BUSINESSWEEK
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Hagar and his three fellow band members—Eddie and Alex Van Halen, and Michael Anthony—invested about \$400,000 in the first bar. MTV hosted the opening night party in 1992, but after that splash, business slowed to a trickle. "The guys in Van Halen got sick of it," says Hagar. "We lost about \$40,000 a year—pocket change to those guys. But they said the place was too hot,

there were no telephones, and no TV." Hagar took sole ownership in 1994 and hired a new manager to run the bar. Then he decided he wanted to produce his own tequila for the cantina's customers.

After sampling offerings at distilleries, Hagar partnered with the Rivera family, which has owned a distillery in Jalisco since 1937. They sent Hagar handmade tequila in jugs, vats, and five-gallon gas cans, and he served it in porcelain bottles with cork stoppers. In 1999, Wilson Daniels, a wine importer in St. Helena, Calif., asked about distributing Cabo Wabo Tequila in the U.S. It sold 37,000 cases the first year.

Cabo Wabo President Stephen Kaufman says Cabo sold 140,000 cases last year, making it the country's second best-selling brand of premium tequila.

U.S. sales of tequila rose 12% in 2006, according to AC Nielsen, Scantrack and LiquorTrack, and companies such as Diageo, S. Graham, and Allied Domecq are introducing high-end labels.

In 2006 there were 40 new premium tequilas, compared with 13 in 2004, says Eric Schmidt, manager for information services at Nielsen.

At Nielsen (Conn.) researchers Adams Beverage Group. "Cabo Wabo has created a great niche," he says. "As far as the affiliation with Hagar and the party atmosphere they've done very well."

In 2004, Hagar opened a second cantina at Harrah's in Lake Tahoe. A third in Las Vegas, is scheduled to open in 2007. Hagar is considering opening others in Orlando, Atlantic City, and Fresno, Calif., but fears turning them into a cookie-cutter chain. The 200-employee company has expanded tequila sales into Canada, Australia, and Mexico, and plans a global push. In April, Hagar launched Cabo Wabo Añejo Reserva, a \$250 limited-edition reserve label.

Hagar works with only a handful of employees, including Kaufman, a liquor industry vet, at Cabo's main office. Marketing is a grassroots effort. In 1999, Hagar wrote the party anthem *Más Tequila* and mentions the brand in interviews. On tour with his band the Waboritos (he left Van Halen in 1996), he shares stage with bikini-clad waitresses serving tequila. For now, Hagar is content both to play the party and to host the bar. "I'm owning and operating a business," says. "It's as creative as stepping on stage or making a record." ■

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ONLINE: For a slide show on the making of Cabo Wabo Tequila, go to businessweek.com/go/cabowabo



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Owners of variable annuities have a versatile vehicle in their portfolio. Committed assets typically get invested on a tax-deferred basis, usually in mutual funds, where they have a chance to grow with financial markets. Even after regular payments have begun, underlying assets may in many cases keep growing. Upon the owner's death, beneficiaries receive payouts akin to a life insurance settlement.

Now the variable annuities marketplace counts more than 1,000 distinct products—a 400 percent increase over the past decade, according to the National Association for Variable Annuities (NAVA)—including some for cost-sensitive investors as well as those who appreciate firm guarantees.

In approaching retirement, investors face a whole new set of challenges as they shift to a portfolio that's often heavy with fixed-income instruments. For starters, they need to minimize risk while still staying ahead of inflation. But many also need to keep growing assets in order to provide for the unpredictable.

"Sometimes it's hard for people to know five or six or even 10 years in advance what they really going to need in retirement," says Patricia Colby, principal for annuity and insurance services at Vanguard. Such uncertainty, she says, heightens the importance of keeping options open — and finding investment vehicles that take full advantage of bull markets.

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To meet these needs and also satisfy a thirst for reliable income, insurers are offering variable annuities with "living benefits" riders that are getting a warm welcome in the marketplace. Investors opted for them in 89 percent of new variable annuities sales from the first half of 2006, according to NAVA data.

Sales patterns from recent years suggest one of the hottest items in this "living benefits" category is the Guaranteed Minimum Withdrawal Benefit (GMWB), and it's easy to see why retirees and boomers like it so much. Even if markets tank and the value of invested assets plummets, this rider promises payouts calculated at high points in the portfolio's historic performance. What's more, through benefits known as "GMWB for Life," underwriters make sure payments of a fixed size continue for as long as an individual or couple may live.

Bottom line: investors who opt for these benefits can stay in the potentially lucrative stock market without worrying that income streams in their twilight years could vanish overnight.

"Living benefit guarantees have entirely changed the nature of the variable annuity solution for the investor," says David Odenath, president of Prudential Annuities. "They allow investors to enjoy much of the upside of the market, but have protection against the downside of the market."

An impending wave of boomer retirements has helped make variable annuities the fastest-growing sector of insurance products. The industry counted \$1.3 trillion in assets in the first quarter of 2006, up 14.2 percent from a year earlier and 61.2 percent from 2002. As the industry grows, so also has the pace of mergers and acquisitions as companies position themselves to be leaders. The number of firms selling variable annuities dropped from 61 to 45 between 1996 and 2005, according to NAVA.

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>> Annuities are under-priced, not over-priced. Those expenses are buying you two really important features: a death benefit [and] a lifetime income benefit. And if that didn't have any value, then why is it that corporations are taking it away from employees?

Steve Lovell, Financial Planner

To stay ahead in this hot industry, companies are tailoring innovations to curb risk and boost returns simultaneously. In November 2006, for instance, Prudential expanded options available through its Lifetime Five series, which had already guaranteed annuitants a cash flow of five percent of invested assets for life. With its unique Highest Daily Lifetime Five product, Prudential now records the value of underlying assets every day the market is open, thus enabling investors to lock in payments of five percent of asset values at their absolute historic peak.

In exchange for offering upside market potential while mitigating an investor's risk, issuers of variable annuities charge fees. Costs associated with managing assets in mutual fund "sub-accounts" tend to be slightly lower than investors would pay if they bought into the same funds directly, according to Michael DeGeorge, vice president and general counsel at NAVA. Beyond those charges, issuers collect a mortality and expense (M&E) fee; the industry's average M&E charge is 1.2% of assets per annum. Additional fees sometimes apply for specific riders and death benefits.

Finding Value in Annuities

In the past, some investors have shied away from variable annuities in order to avoid the fees and retain more flexibility. But now investors have more choices and flexibility than ever before, and some financial planners believe today's revamped products have become a bargain.

"Annuities are under-priced, not over-priced," says Stephen Lovell, a financial planner in Walnut Creek, Calif. "Those expenses are buying you two really important features: a death benefit [and] a lifetime income benefit. And if that didn't have any value, then why is it that corporations are taking it away from employees?"

Even so, price-sensitive investors are always inclined to sniff out low-cost options. For them, mutual fund giant Vanguard has teamed up with two insurers to cut out middlemen and sell variable annuities directly to customers. Investors get access to low-cost Vanguard funds for their underlying assets, and they forego some of the living benefit guarantees that drive up fees elsewhere.

Result: a variable annuity whose expense ratio of .57% puts it well below the 2.34% average for the industry.

As the variable annuity industry evolves, investors are clearly finding a wide range of newly tailored products to suit their own evolving needs and budgets. And that's good, because in an age fraught with retirement uncertainties, they just might want a few new options. ■

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Surprising Dubai

From downhill skiing to golf and nightclubbing, visitors can expect the unexpected in the desert emirate.

BY STANLEY REED

I WAS STRANDED IN DUBAI on a Friday, the sabbath in the Islamic world, and the temperature was a sticky 86F. A sandstorm had scotched my boating date, and going to the beach seemed equally pointless. So I went skiing. There is a snow-covered hill at Mall of the Emirates, one of the largest shopping centers in the world. When you see the boulders, fake pines, and real ice sculptures, it is magical—not less so for being totally incongruous in a mall. Kids in blue winter suits pound each other with snowballs as skiers rise into the distance on a chairlift. There is a toboggan run, even a busy ski

school. A two-hour lift ticket goes for about \$45, and Ski Dubai furnishes equipment as well as outerwear, although you need to bring or buy gloves and hats. The indoor temperature is 23F.

As I slid downward on the quarter-mile run, keeping a wary eye out for snowboarders, I thought to myself: This is so Dubai. The city state, which has a population of 1.4 million and an area of 1,500 square miles—half as large as Rhode Island—is one of the seven states on the southern



FLAGSHIP The superluxe Burj Al Arab hotel

eastern shore of the Persian Gulf that make up the United Arab Emirates. While larger Abu Dhabi floats on the money gusher from one of the world's richest oil troves, Dubai thrives on its commercial skills and imagination.

Whatever its entrepreneurial leaders conjure up quickly becomes reality. That could be anything from the tallest building in the world, the Burj Dubai, which is rising from the desert floor at the rate of a story every three days, to the ultimate monument to excess, the Burj Al Arab hotel. This 1,000-foot-tall structure is an abstract rendition of a ship, complete with a gigantic Teflon-coated sail. The Burj Al Arab's interiors drip with 22-karat gold leaf, and its rooms, all suites, start at \$2,000 a night.

Global banks are rushing to set up offices in the new Dubai International Financial Center. Corporations from Microsoft to Cisco Systems are opening regional or, in Halliburton's case, world headquarters there. So business travelers are increasingly likely to find themselves in the garish little emirate with its clogged streets and pricey hotel rooms.

A visitor will find plenty to do in Dubai after work or between meetings. Restaurants of every description abound, from the superb but low-key Lebanese eatery Al Borah in the mall beneath the Jumeirah Emirates Towers hotel to the haute cuisine at Vu's on the 50th floor.

Dozens of shopping malls feature about every name-brand store from J. J. Willy Nichols to Louis Vuitton. Prices are good, thanks to low import duties and a currency linked to the U.S. dollar. The malls are great places to observe Dubai's rich mix of people, from

Saudi women in full black veils (though they're not obligatory) to local youths with spiky hairdos.

Dubai can be a painless introduction to what may otherwise seem a forbidding part of the world. A Muslim country, it stands out for its tolerance toward other religions. Unlike somber Iran and Saudi Arabia, Dubai allows alcohol consumption and turns a blind eye to a relatively unfettered nightclub scene.

LINED WITH DHOWS

TO GET A FEEL OF the heart of Dubai, take a walking and boating expedition along Dubai Creek, the eight-mile salty inlet that used to be the emirate's commercial lifeblood. Start at the Dubai Museum, housed in a mud-walled fort in a part of town called Bur Dubai where the original settlement dates back to the mid-19th century. Its collections of antique watercraft and huts made of date-palm fronds are fascinating reminders of how much the once-sleepy trading entrepôt on the banks has transformed in a few decades. If you don't want to navigate yourself, a company called Big Bus offers a guided walk as part of its tour.

From the museum, the route to the creek takes you through alleyways that boast Indian temples and colorful flower stalls—hints that roughly half of Dubai's population hails from South Asia. There's also a blue-tiled Shiite mosque built by the Iranian community.

At the creek you can board an *abra*, or 20-passenger water taxi, for the bargain fare of one dirham, about 25¢. You will be traveling with the people who do the real work: Indian and Pakistani tradesmen and laborers. While modern shipping has moved down the coast to the huge port of Jebel Ali, the creek's banks are lined three- and four-deep with dhows, wooden vessels that carry everything from electric generators to cases of Coca-Cola across the Gulf to Iran. Their ancient shapes groan and heave against a backdrop of steel-and-glass towers.

Get off on the east side, known as Deira. In the vibrant and earthy souks, you can buy a traditional man's robe, called a *dishdasha*, or the heavy silver jewelry that has lost out to gold as the region has become wealthier.

In the spice souk not far from the *abra* landing, the air is full of the gray smoke

of frankincense, available for purchase along with sandalwood, vanilla, and fancy little packages of saffron. Farther away from the creek is the gold souk, with some 400 shops offering an astounding array of designs, including filigreed chokers of mind-boggling complexity that would cover much of a woman's chest. Dubai is one of the cheapest places in the world to buy gold, which is fashioned in India and largely sold by weight, not level of workmanship.

Another way of getting a taste of Arabia is a desert safari, around \$80 per person for a group tour, including dinner. About 40 minutes outside the city, your driver will let some of the air out of the SUV's tires and take you on a gut-wrenching cruise up and down the dunes. The experience won't be exactly like crossing the arid wilderness of the Empty Quarter on camelback, but the red sands and the lush desert

plants, especially after spring rains, are lovely. At a desert campsite I met baby camels that were as friendly as puppies.

The beauty of Dubai is that you can do just about anything there, despite being on the austere Arabian peninsula: play golf (fees run up to \$170, not including carts and equipment), go to the beach, hit the racetrack. The winter

thoroughbred racing season culminates in the Dubai World Cup, which this year was on Mar. 31 and had a purse of \$6 million, billed as the world's richest.

If you are staying in a top hotel, you can find a sufficient variety of restaurants to keep yourself satisfied for a day or two without leaving the premises. For evening entertainment, I enjoyed JamBase, a relaxed, wood-paneled club at Souk Madinat Jumeirah where you can have dinner and listen to an American chanteuse fronting a live jazz band. Among the cool young locals, the preferred venue seems to be the Peppermint Club, which convenes on Friday nights at the Fairmont Hotel. The music is so loud it hurts, and young female employees in uniform white-denim hot pants slither among the crowd of black T-shirts and slinky dresses to encourage dancing. That's another thing you don't expect to encounter in this part of the world. ■

BusinessWeek .com

ONLINE: For a tour of Dubai, visit www.businessweek.com/extras.



BY JONATHAN SCHWARTZ

The Sad Side of Love, Sweetly Sung

MANY YEARS AGO, REGGAE artist Jimmy Cliff recorded a song of his own, *Sitting in Limbo*, that I fondly recall. It's a song about ambivalence, about being neither here nor there. It's also the title of Jessica Molaskey's moving new CD, which considers the relationships between men and women from the point of view of gray, rather than black and white. That ambivalent area is, after all, where many of us spend our romantic lives, with flashes of "sadness or euphoria," as Billy Joel

writes in *Summer, Highland Falls*, a song Jessica sings so reflectively on *Sitting in Limbo*.

What we have here is a Broadway Baby, a woman in her 40s who has lent service as a singer, dancer, or actress to numerous excessive shows, from *Cats* to *Les Misérables*, as well as worked with the theater's most prestigious creators, Hal Prince and Stephen Sondheim. In 1997, in a flop called *Dream*, a whirling, ill-conceived tribute to America's most prolific lyricist, Johnny Mercer, Molaskey met John Pizzarelli. Son of the famous guitarist Bucky Pizzarelli, John is himself a world-class guitarist and, through the years, has become an excellent pop singer. Jessica's marriage to John flourished over their shared devotion to Madeleine, their only child (now 9), and with the daily encouragement they brought to one another.

Jessica pushed him out there, as the brilliant musician he is, as the extraordinary mimic he has always been, and as the extemporaneous vaudevillian he has so naturally become. In turn, John maneuvered her into recording studios for what has become a series of four ironic and cerebral albums, the first of which, *Pentimento*, was gently presented to me through earphones on an airplane (I didn't



JESSICA MOLASKEY

know it existed) as John Pizzarelli and I flew to Las Vegas for a radio convention five years ago.

There it was, an absolutely original sound, a point of view realized by a quiet presentation of recognizable old songs: *When the Red Red Robin Comes Bob-Bob-Bobbin' Along* and *I'm Just Wild About Harry*, among others.

In time, Jessica joined the John Pizzarelli Quartet, although not on every gig, to provide self-deprecating warmth and occasionally keep her goofily spontaneous husband in check. All the while her CDs sold consistently, and now, in

the spring of 2007, comes a sobering consideration of the subtext of marriage, both sadness and the euphoria.

Listen to her rendition of *Hearts and Bones*, a song written to its creator, Paul Simon, and until now never recorded on an album by another artist. Aided only by the spare guitar of Pizzarelli, Jessica sings from a feminine and melancholy perspective.

Jessica and John wind up Mitchell's *Circle Game* with Antonio Carlos Jobim's *Walters of March* around each other, supplying depth to both. Her *There'll Never Be Another You* is nothing short of a poignant wail of regret

and longing.

There is so much else to relish on *Sitting in Limbo*. The CD will be released on May 8 by PS Classics, and Jessica will perform with John at New York's Carnegie Hall in May. Expect to hear much of her CD and, I'm told, a related number she did not record on the album: Stephen Sondheim's truthful song about marriage, *Sorry Grateful*.

Serious business. Wonderful music.

Jonathan Schwartz hosts *High Standards*, a channel on XM Satellite Radio, as well as weekend shows on WNYC-FM, a New York public radio station.

JESSICA MOLASKEY
Sitting in Limbo
PS CLASSICS



BY ROBERT PARKER

A Superlative New Generation in Provence

DOMAINE PIERRE USSEGLIO, a 53-acre estate in Provence's Châteauneuf du Pape appellation, always made good wine. But when Pierre's sons, Thierry and Jean-Pierre, took over the winemaking at the domaine in the mid-1990s, the quality rose to world-class. Besides their classic Châteauneuf du Pape cuvées, the brothers produce a gorgeous Côtes du Rhône and a very good, inexpensive table wine.

2004 vintage Panorama Vin de Table
6 points. Mainly merlot, the wine has notes of spice, earth, black fruits, and some dusty tannins. It has a lean and sinewy finish. **\$12**

2005 Côtes du Rhône
8 points. Made with 90% grenache and 10% syrah, the wine reveals nice berry fruit with some spice, pepper, and dusty, loamy notes. It is dark ruby, medium-bodied, and lively, but with good acidity and light tannin. Drink it over the next four to five years. **\$16**

2005 Châteauneuf du Pape Tradition
24 points. Dense purple in color, this wine displays notes of raspberry, black cherry, and even some black currant and licorice. Return- to full-bodied, with acidity, moderate tannin, outstanding ripeness and richness, it will be at its best in two to three years and drink well for 15. **\$25-\$35**

2003 Châteauneuf du Pape Tradition
20 points. The 2003 Tradition is a full-bodied peppery wine with having notes of lavender, pears, and sweet black cherries and raspberries, oozes with the essence of Provence. Some spice, saddle leather, and a sea breeze notes also weave it into the character of a concentrated wine, which is

silky enough to drink now or cellar for 10 to 12 years. **\$30-\$40**

2004 Châteauneuf du Pape Cuvée de Mon Aïeul

94 points. This 100% grenache cuvée exhibits a deep ruby purple color and a wonderful sweet nose of black cherry, raspberry, licorice, spice box, and roasted herbs. With full body and decent acidity, this wine should drink beautifully for 12 to 15 or more years. **\$75-\$100**

2003 Châteauneuf du Pape Cuvée de Mon Aïeul

97 points. One of the vintage's most

profound wines, this Cuvée de Mon Aïeul has a dense purple color as well as a glorious nose of blackberries, licorice, smoke, and some hints of roasted meats and dried herbs. Amazingly opulent with extraordinary purity, it leaves a huge tactile impression on the palate without being heavy. Anticipated maturity: now to 2020+. **\$95-\$121**

2003 Châteauneuf du Pape Réserve des Deux Frères

98 points. This wine has a high, 16.5% alcohol content, but you would never know that from tasting it. Dense purple to the rim, with a huge nose of scorched earth, blackberry and blueberry liqueur, crème de cassis, and roasted meat juices, it also has a hint of Provençal herbs interwoven with licorice and a touch of balsamic. The wine is voluptuously textured, with striking body, low acidity, and amazing concentration. This fabulous bottle should drink well for 20+ years. **\$170-\$202**

Robert Parker is the world's most influential wine critic. Visit eRobertParker.com to see tens of thousands of tasting notes, buy his books, or subscribe to his newsletter, The Wine Advocate.



Wines rated from 96-100 are extraordinary; 90-95, excellent; 80-89, above average to very good. For more Parker picks, go to businessweek.com/extras.

Spin-Off Spotting

Corporate castaways can yield outsized returns, as long as you choose carefully and bide your time before buying in. **BY AARON PRESSMAN**

INVESTING IN CORPORATE spin-offs is a time-proven strategy for beating the market, and 2007 will offer up a lot of opportunities to buy what many big corporations no longer want. Among the higher-profile deals will be Tyco International's plans to set up its electronics and health-care businesses as freestanding units and Morgan Stanley's long-expected divestiture of the Discover credit-card unit.

Just how good have spin-off returns been? A recent Lehman Brothers study found that from 1990 to 2005, spin-offs beat the Standard & Poor's 500-stock index by 18% on average in their first two years of independence. Most recently, an index of spun-off companies compiled by Clear Asset Management in New York beat the S&P 500 by almost 11 percentage points a year over the past five years.

Not every spin-off is a winner, and investors need to examine the deals with care. One clue to the fate of a newly freed unit is to look in the executive suite. Are the current executives staying or

jumping ship? "Management has access to superior information," says William Mitchell, who writes the monthly newsletter *Spinoff and Reorg Profiles*. So if the CEO goes with the new business, "it's a signal the business is particularly attractive," says Mitchell.

Another key is the method chosen for

the spin-off. Many split-ups are accomplished by the parent company simply distributing ownership of an unwanted unit to shareholders. That usually means no road show or other promotions that can pump a lot of hype into a spin-off's shares. Two of the worst-performing spin-offs of recent years, AT&T Wireless and Lucent Technologies' Agere Systems, were accompanied by much ballyhooed initial public offerings.

Timing your purchases is also critical. Buying shares of parent companies in anticipation of the spin-offs isn't the best approach. Spin-off shares often trade down in the weeks and months after they hit the market. That's because investors unload the spun-off shares, which are not in any underlying index.

Many companies also cast off units to free themselves of looming lawsuits, parent fights, or punishing debt. "There are many reasons why companies are getting spun off, and they're not all good," says Andrew Corn, CEO of Clear Asset Management, a New York hedge fund manager.

Most of this year's spin-offs have to release plans detailing how much debt and other liabilities they'll carry or which executives will run the new companies. But there's plenty of time to scrutinize spin-offs once they start trading, as you wait for the initial selling to subside over two to three months, says John Keeley, manager of the Keeley Small Cap Value Fund. "I take a few months to go through all the SEC filings," Keeley says. "Then I sit back and wait for it to happen."

The most talked-about spin-off this year is Tyco International's plan to split into three parts. The health-care and electronics divisions will become separate companies, and the remainder of Tyco will focus on fire and industrial equipment and security through its ADT Security



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systems unit. Some of Tyco's \$10 billion load will be distributed to the spin-off, although the exact amounts aren't known.

The electronics unit is the "most intriguing," says Andy Ramer, an analyst with the FMI Large Cap Fund. Margins improved by surging copper prices over the past three years ought to improve, and the company is pushing into the faster-growing consumer-electronics market, Ramer says. The health division, being renamed Covidien, intrigues Mitchell.

It's an easy-to-understand part of a hard-to-understand conglomerate," he says. He expects a lot of short-term selling of Covidien shares because it won't be included in any index component.

American Standard, another giant looking to slim down, is dumping its Wabco unit to concentrate on the air-conditioning busi-

ness. Wabco, which makes electrical and safety systems for trucks and buses, will be debt-free and should earn the equivalent of about \$1.20 a share in 2007, making it worth \$23 a share, according to analysts at Prudential Equity Group. The deal is expected in September.

Temple-Inland decided to restructure with a little prompting from activist shareholder Carl Icahn, who bought up almost 7% of the manufacturing and real estate company. The result is another case of a spin-off in an out-of-favor industry, a situation that often yields great bargains for long-term investors, fund manager Keeley says. Temple-Inland will give its shareholders ownership of Guaranty Financial Services, a bank that specializes in mortgage lending, and Forestar Real Estate Group, which owns 236,000 acres of developable land, mostly around Atlanta, and another 100,000 acres of

timberlands. Temple-Inland hasn't disclosed full details of its plan, such as how much debt each unit will end up with, but analysts at Lehman Brothers say the bank, which earned \$222 million in 2006, is worth about \$2.7 billion. Lehman values Forestar, which earned \$62 million, at about \$800 million.

In a deal that may upstage Tyco, Morgan Stanley officials have said they plan to spin off Discover Financial Services, the fourth-largest credit-card network, in the third quarter. The deal is planned as a tax-free distribution to current Morgan shareholders. With net income of about \$1 billion last year and comparable companies like MasterCard doing well, a freestanding Discover should be worth \$13 billion to \$15 billion, three analysts at Deutsche Bank wrote earlier this month.

None of the spin-offs mentioned have a firm timetable, so if you're interested, keep on top of the news. Once the spin-offs start trading, it's time to start bargain-hunting. ■

Watch for deals in which the CEO stays with the unit

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What's Wrong With ETFs?

They encourage frequent trading, which helps Wall Street more than investors, says the father of the index fund. **BY JOHN C. BOGLE**



SINCE HE FOUNDED Vanguard Group Inc. in 1974, John C. “Jack” Bogle has used his position as a bully pulpit for low-cost investing. But in the decade since he retired as chairman and chief executive officer, the 77-year-old Bogle has emerged as the mutual fund industry’s most outspoken critic, railing hardest against funds with high fees and cruddy performance.

In his latest volume, *The Little Book of Common Sense Investing: The Only Way to Guarantee Your Fair Share of Stock Market Returns* (John Wiley & Sons Inc., \$19.95), Bogle continues to press his case for investing in index funds because of their low costs, minimal taxes, and predictable returns—that is, investors should earn whatever the market earns. In the excerpted chapter below, Bogle argues that many of the newly popular exchange-traded funds (ETFs), which are presented as index funds, are in fact gimmicks with dangerous implications for investors.

Traditional indexing is under challenge by a sort of wolf in sheep’s clothing, the exchange-traded fund. Simply put, an ETF is a fund designed to facilitate trading in its shares, dressed in the guise of a traditional index fund. But the differences between a classic index fund and the index fund nouveau are stark. ETFs march to a different tune than the original, and I’m left to wonder, in the words of the old song, “What have they done to my song, ma?”

The first ETF, created in 1992, was named “Standard & Poor’s Depository Receipts” (SPDRs) and quickly dubbed “Spider.” It was a brilliant idea. Investing in the Standard & Poor’s 500-stock index, operated at low cost with high tax efficiency (since it doesn’t trade stocks, taxable distributions are minimal or nonexistent), and held for the long term, it appeared to be a ferocious new competitor to the traditional S&P 500 index mutual fund. (Brokerage commissions, however, made it less suitable for investors making small investments regularly.)

Most Spider investors, however, were not long-term investors. They were active money managers, hedgers, professional traders. Currently, some 65 million share Spiders (\$8.8 billion worth) are traded every day.

From that single fund, ETFs have grown to be a 14 percent—\$410 billion—of the \$1 trillion index fund asset class, a 41% share, up from just 9% as 2000 began and only 1% a decade ago. Their amazing growth certainly says something about the energy of Wall Street’s financial entrepreneurs, the focus of money managers on gathering assets, the marketing power of brokerage firms, and the willingness—eagerness—of investors to favor complexity over simplicity, continuing to believe, against all odds, that they can outperform the market.

The growth of ETFs has approached a stampede, not in number but in diversity. There are now nearly 340 ETFs available, including 122 formed during 2006, and the range of the investment choices is remarkable. (Early in 2007, the investment choices were more limited.)

more ETFs were on the
ing board.) There are 12
market index funds (U.S.
international) with the
er still the largest segment
rms of assets, 68 focused
vestment styles, 173 based
stock market sectors, and 58
entrating on particular for-
countries. There are also
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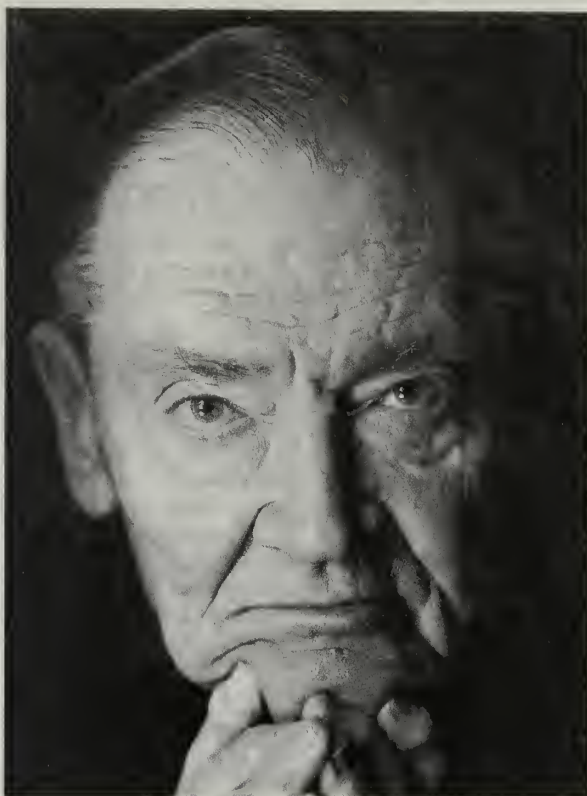
broad-based ETFs are the
ones that can replicate,
possibly even improve on,
classic index fund. Their
ual expense ratios are usu-
—but not always—slightly
r than their mutual fund
terparts, though com-
ions on purchases erode
advantage and may even
whelm it. While their tax
iency should be higher, ac-
practice so far has failed

confirm theory, and investors who trade them are sub-
to their own taxes. Their use by long-term investors is
lunatic. Spiders are, in fact, marketed to day traders. As
advertisements say: "Now you can trade the S&P 500
ay long, in real time." I can't help likening the ETF to
renowned Purdey shotgun, supposedly the world's best.
great for big-game hunting. But it's also excellent for
ide.

I suspect that too many ETFs will prove, if not suicidal to
owners in financial terms, at least wealth-depleting. We
v that ETFs are largely used by traders because the turn-
of Spider shares is running at a 3,600% annual rate.
turnover for the NASDAQ Qubes (an ETF based on the
DAQ 100 stock index) is even higher: 6,000% per year.
only guesswork, but long-term investors hold perhaps
of the \$100 billion assets of these Spider-like broadly
rsified ETFs. The remaining assets, I presume, are held
market makers and arbitrageurs making heavy use of
t-selling and hedging strategies.

FAST DEPARTURE

ADING IN THE MAJOR-SECTOR ETFs is also remarkably
. The shares typically turn over at an average annual
of 200% per year (an average holding period of just
months), with the most popular ETFs recently running
over rates from 578% to 735%, all the way up to 7,100%
sell 2000 iShares, a small-cap stock index) and 8,500%
OR Energy shares). In all, some \$390 billion of the cur-
\$410 billion ETF base represents a vast departure from
beneficial attributes of the original index fund. Could
e be speculation going on here?



Sector ETFs as a group are virtually certain to earn lower returns than the market



ter: "What have they done to my song, ma?" As the creator of
the world's first index mutual fund all those years ago, I can
only answer: "They've tied it up in a plastic bag and turned it
upside down, ma, that's what they've done to my song."

In short, the exchange-traded fund is a traitor to the cause
of classic indexing. I urge intelligent investors to stay the
course with the proven strategy. While I can't say that classic
indexing is the best strategy ever devised, our common sense
should reassure you that the number of strategies that are
worse is infinite. ■

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Wiley & Sons Inc., from *The Little Book of Common Sense
Investing: The Only Way to Guarantee Your Fair Share of
Stock Market Returns*, by John C. Bogle. Copyright © 2007
by John C. Bogle.

Yes, these specialized ETFs
are diversified, but only within
their narrow arenas. Owning
the semiconductor industry is
not diversification in any usual
sense, nor is owning the South
Korean stock market. And
while sector ETFs frequently
have the lowest expense ratios
in their fields, they can run
three to six times the level of
the lowest-cost, broad-based
index funds.

The net result of these dif-
ferences is that sector ETFs as
a group are virtually certain
to earn returns that fall well
short of those delivered by the
stock market. Perhaps 1% to
3% a year is a fair estimate of
these all-in costs, many times
the 0.1%-to-0.2% cost of the
best classic index funds. It is
not a trivial difference.

Whatever returns each sec-
tor ETF may earn, the investors
in those very ETFs will likely, if
not certainly, earn returns that
fall well behind them. There
is abundant evidence that the
most popular sector funds of
the day are those that have re-
cently enjoyed the most spec-
tacular recent performance
and that investing in them
after the fact is a recipe for dis-
appointment. One lesson I've
learned over the years is that
mutual fund investors almost
always do significantly worse
than the funds they own, and
that lesson is likely to be re-
peated in ETFs.

Let me now address what I
noted at the outset of this chap-



BY GENE G. MARCIAL

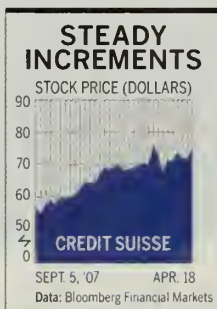
MORE BOOMERS LET **CREDIT SUISSE** MANAGE THEIR PORTFOLIOS

CARDIAC SCIENCE DEFIBRILLATORS—AT AIRPORTS AND STADIUMS

DOES A SPEEDY RECOVERY LIE AHEAD AT **HOME SOLUTIONS**?

Up and Up: Credit Suisse

CREDIT SUISSE GROUP (CS) is the No. 2 bank in Switzerland and a biggie in global finance. But to the smart-money crowd, it is one of the most undervalued wealth-management plays. Some 40% of its profit comes from asset management, and its business is enjoying double-digit annual growth. Most asset management outfits trade at 17 to 20 times earnings. "CS is way undervalued on that basis alone," says John Maloney, president of M&R Capital Management, which owns shares. CS stock, up from 68 in January to 75.04 now, trades at only 13.3 times his estimated 2007 earnings of \$5.60 a share, and 11.9 times the 2008 estimate of \$6.30. If CS were valued just as an asset manager, it would command a price of 133 in two to three years, he says. "Asset management is a fast-growing field," adds Maloney, "thanks to increased wealth concentration among baby boomers." And CS will gain, too, from new fortunes in Asia and Latin America. Over three to five years, Maloney sees even wider margins for CS in asset management and investment banking. A new CEO, Brady Dougan, replaces Oswald Gruebel in May, and Maloney expects he'll cut costs, improving margins further. Jeremy Sigee of Citigroup (it has done banking for CS), who rates CS a buy, says the company trades at a discount to its sum-of-the-parts value. He has a 12-month price target of 95.



More Public Appearances For Cardiac Science

SUDDEN CARDIAC ARREST strikes people everywhere, and an automated external defibrillator (AED) to restore normal heartbeat can be a lifesaver. Airports, sports arenas, and government agencies are installing the devices. Cardiac Science (CSCX), which makes AEDs and other systems for patients with heart ailments, is a big beneficiary. Its solid fourth-quarter results were due to a 41% jump in AED sales. Tops in the field is Medtronic, which suspended product shipments in January because of quality issues raised by the Food & Drug Administration. As No. 3, Cardiac Science has a 20% market share with 2006 sales of \$155 million. "The outlook for the AED market is robust," says CEO John Hinson,

because of growing awareness that the devices are needed in public places. Dalton Chandler of investment firm Needham sees Cardiac Science's AED sales rising 18% in 2007. He rates the stock, now at 9.49, a buy. With several catalysts surfacing in 2007, "we view CSCX as an attractively valued solid long-term story," says Jonathan Block of SunTrust Robinson Humphrey, who has a 12-month stock price target of 12.



Home Solutions Is Rebuilding after a Storm

HOME SOLUTIONS OF AMERICA (HSOA), a provider of recovery and rebuilding services when houses or offices have been damaged by flood, fire, or other calamities, acts like a first responder. States and insurers hire Home Solutions for such work. On Apr. 9 it was selected for a \$13.7 million New Orleans infrastructure project, including rebuilding school playgrounds, sidewalks in the French Quarter, and the Orleans Parish sheriff's office. "HSOA has a large number of backlog orders, and it expects 25% of 2007 revenues to come from New Orleans," says Bert Francis of Missouri Valley Partners, which owns 910,000 shares. The stock dropped from 7 on Feb. 5 to 4.83 on Apr. 18 because of delays in contract payments and heavy short-selling. The bears fear that stiff competition and funding problems will make HSOA run short of money. But Francis isn't worried: "HSOA missed its estimates in 2006, but we expect a recovery in 2007." Francis sees HSOA rising to 8.25 in a year. David Yuschak of Sanders Morris Harris (it did banking for HSOA) rates it a buy and forecasts profits of 61¢ a share in 2007 on sales of \$9 million and 79¢ in 2008 on \$273 million, up from 39¢ in 2006 on \$127 million. He expects the rebuilding of the Gulf Coast will finally get funding from the government and insurers.



BusinessWeek.com

ONLINE: Gene Marcial's Inside Wall Street is posted at businessweek.com investor at 5 p.m. EST on the magazine's publication day, usually Thursday. **Note:** Unless otherwise noted, neither the sources cited in Inside Wall Street nor the firms hold positions in the stocks under discussion. Similarly, they have no investment banking or other financial relationships with them.

OCKS

S&P 500



IMENTARY

rd first-quarter profits at organ Chase pushed the ket into overdrive this week. e Mae's shares soared on news of its \$25 billion ut by private equity. The also boosted other stocks investors consider a target, as Countrywide Financial, h rose 14%. Meanwhile, Immune climbed 23% on rts it's in talks with a suitor.

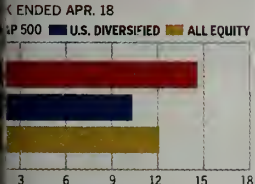
Bloomberg Financial Markets, Reuters

UTUAL FUNDS

WEEK TOTAL RETURN



WEEK TOTAL RETURN



Standard & Poor's

U.S. MARKETS

	APR. 18	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P 500	1472.5	2.3	3.8	12.6
Dow Jones Industrials	12,803.8	2.6	2.7	13.6
NASDAQ Composite	2510.5	2.1	3.9	6.6
S&P MidCap 400	875.3	1.7	8.8	9.2
S&P SmallCap 600	423.2	1.7	5.8	6.5
DJ Wilshire 5000	14,858.4	2.2	4.5	12.3

SECTORS

			% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
BusinessWeek 50*	824.2	1.9	3.2	4.4
BW Info Tech 100**	461.1	1.8	3.0	13.9
S&P/Citigroup Growth	675.2	2.3	3.5	10.4
S&P/Citigroup Value	796.1	2.4	4.2	14.8
S&P Energy	482.2	1.2	5.9	12.0
S&P Financials	496.8	3.9	0.3	12.0
S&P REIT	207.3	1.3	4.3	24.5
S&P Transportation	281.4	3.5	6.7	-2.1
S&P Utilities	209.9	1.2	12.5	34.2
GSTI Internet	210.8	0.4	5.6	7.1
PSE Technology	915.5	2.3	4.6	4.2

*March 19, 1999=1000 **February 7, 2000=1000

GLOBAL MARKETS

	APR. 18	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P Euro Plus (U.S. Dollar)	2180.5	2.3	9.6	29.8
London (FT-SE 100)	6449.4	0.6	3.7	6.7
Paris (CAC 40)	5836.0	1.5	5.3	14.5
Frankfurt (DAX)	7282.3	1.8	10.4	23.4
Tokyo (NIKKEI 225)	17,667.3	0.0	2.6	2.5
Hong Kong (Hang Seng)	20,777.1	1.6	4.1	24.9
Toronto (S&P/TSX Composite)	13,712.0	2.3	6.2	10.2
Mexico City (IPC)	29,559.5	1.0	11.8	49.1

FUNDAMENTALS

	APR. 17	WEEK AGO	YEAR AGO
S&P 500 Dividend Yield	1.79%	1.82%	1.77%
S&P 500 P/E Ratio (Trailing 12 mos.)	17.6	17.3	17.9
S&P 500 P/E Ratio (Next 12 mos.)*	15.2	15.0	14.9
First Call Earnings Surprise*	4.90%	12.50%	7.13%

*First Call Corp.

TECHNICAL INDICATORS

	APR. 17	WEEK AGO	YEAR AGO
S&P 500 200-day average	1370.0	1364.7	Positive
Stocks above 200-day average	78.0%	76.0%	Negative
Options: Put/call ratio	0.88	0.82	Positive
Insiders: Vickers NYSE Sell/buy ratio	5.41	6.04	Negative

BEST-PERFORMING GROUPS

	LAST MONTH %		LAST 12 MONTHS %
Coal	19.2	Tires & Rubber	140.7
Health-Care Facilities	16.4	Power & Energy Traders	47.3
Commercial Printing	15.0	Leisure Products	39.3
Tires & Rubber	14.3	Electric Utilities	38.7
Divsfd. Metals & Mining	13.9	Intgrd. Telecomms. Svcs.	37.2

WORST-PERFORMING GROUPS

	LAST MONTH %		LAST 12 MONTHS %
Electric Mfg. Svcs.	-4.4	Homebuilding	-30.2
Employment Services	-3.8	Electric Mfg. Svcs.	-27.9
Forest Products	-2.2	Gold Mining	-22.2
Constr. Materials	-1.3	Education Services	-14.0
Building Products	-1.2	Computer Retailers	-12.5

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Latin America	11.5	Utilities	34.7
Pacific/Asia ex-Japan	8.7	Latin America	32.2
Precious Metals	8.5	Pacific/Asia ex-Japan	28.6
Diversified Emerging Mkts.	8.4	Real Estate	27.8
LAGGARDS		LAGGARDS	
Japan	-0.5	Japan	-6.8
Real Estate	1.9	Technology	3.1
Financial	2.7	Small-cap Growth	4.3
Domestic Hybrid	2.7	Mid-cap Growth	6.8

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
DireXn. Lat. Am. Bull 2X Inv.	23.6	iShares MSCI Malaysia Idx.	57.9
ProShares Ultra Oil & Gas	18.6	ProFds. Utilities Ultrasector	52.2
DireXn. Emrg. Mkts. Bull 2X	17.6	iShares MSCI Singapore Idx.	50.3
DireXn. Cmtty. Bull 2X	16.2	E.I.I. Int. Property Instl	50.0
LAGGARDS		LAGGARDS	
DireXn. Emrg. Mkts. Short	-15.7	American Heritage Grth.	-40.0
ProShares UltSh. Oil & Gas	-15.7	DireXn. Emrg. Mkts. Short	-37.0
ProFds UltSh. Emrg. Mkts. Inv.	-13.7	DireXn. Dev. Mkts. Bear 2X	-28.8
ProShares UltSh. Health Care	-11.4	SPDR S&P Homebuilders ETF	-24.8

INTEREST RATES

KEY RATES

	APR. 18	WEEK AGO	YEAR AGO
Money Market Funds	4.87%	4.87%	4.29%
90-Day Treasury Bills	4.97	5.02	4.71
2-Year Treasury Notes	4.64	4.72	4.83
10-Year Treasury Notes	4.65	4.74	4.98
30-Year Treasury Bonds	4.82	4.91	5.08
30-Year Fixed Mortgage †	6.17	6.20	6.42

† BankQuote Inc.

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10YR. BOND	30YR. BOND
General Obligations	3.90%	4.29%
Taxable Equivalent	5.57	6.13
Insured Revenue Bonds	4.05	4.57
Taxable Equivalent	5.79	6.53

THE WEEK AHEAD

CONSUMER CONFIDENCE

May, Apr. 24, 10 a.m., EDT » Conference Board's April consumer confidence index is first to have eased to 105.2, 107.2 in March. That's the lean forecast of economists by Action Economics. **DRUG STORES** Wednesday, Apr. 25, 8:30 a.m., March durable goods orders likely grew 2.5%, after holding 1.7% in February.

NEW HOME SALES Wednesday, Apr. 25, 10 a.m. EDT » New home sales in March probably edged up to an annual rate of 0.89 million units. February sales stood at a pace of 0.85 million houses. **BEIGE BOOK** Wednesday, Apr. 25, 2 p.m. EDT » The Federal Reserve releases its summary of economic conditions ahead of the May 9 monetary policy meeting. Economists expect the Fed to hold interest rates at 5.25%.

GROSS DOMESTIC PRODUCT Friday, Apr. 27, 8:30 a.m., EDT » First-quarter real gross domestic product probably slowed to an annualized growth rate of 2.1%, after a 2.5% gain in the prior period. **EMPLOYMENT COST INDEX** Friday, Apr. 27, 8:30 a.m., EDT » Compensation most likely grew 0.9% in the first quarter, following a 0.8% gain in the fourth quarter of 2006.

The *BusinessWeek* production index improved to 293.5 for the week ended Apr. 7, an 8.2% gain from a year ago. Before calculation of the four-week moving average, the index jumped to 297.5.

BusinessWeek .com

For the BW50, more investment data, and the components of the production index visit www.businessweek.com/extras

It's about money.
Earning it.
Investing it.
Spending it.



Check out this weekend's
show April 21 and 22:

Wal-Mart: Has Wal-Mart lost its low-cost lustre? We compare its prices with Target's.

Financing for Entrepreneurs: Get expert advice on how to convince investors to back your fledgling business.

Online MBA?: See how it works, what it costs, and whether it carries the same cachet as a traditional on-site degree.

Craft Beer Buzz: Learn how small brewers are growing as their specialty beers attract the wine and cheese crowd.

BusinessWeek weekend

Airs Saturday/Sunday nationwide.
Find your local station and airtime by
zip code at businessweekweekend.com

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This index gives the starting page for a story or feature with a significant reference to a company. Most subsidiaries are indexed under their own names. Companies listed only in tables are not included.

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EXPERT INSIGHTS

Reports on Project Management
Software & Team Management

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Why Companies are Making the Switch to "Software as a Service"

...ine looking for new software and see-
system Requirements: Internet Access."
...panding Internet capabilities are allow-
...organizations to expand the traditional
...f software as an off-the-shelf product,
...sed, installed and run on your comput-
...ard drive. Web-based Software as a
... (SaaS) runs entirely through your
...et connection.

...-based applications leverage the capabil-
...the Internet. Creatively using web 2.0
...ologies like AJAX gives web-based soft-
... quick and responsive feel like that
...ed from desktop applications. Choices in
...aS category are growing as aggressive

software developers harness the capacity of the model to serve the growing demands of the business marketplace.

Project and Portfolio Management (PPM) and Customer Relationship Management (CRM) industries are especially progressive in their use of SaaS. Implementing a SaaS solution in this environment is often faster, easier on the budget, and more portable than a desktop installation.

Consider implementation where a quick online setup (about as complex as buying a book from Amazon.com) is all that's required to purchase software licenses and get full collaborative functionality—much faster than deploy-

ing IT staff across the company armed with installation CD's or lengthy download instructions. Teams can be working together in a new application in no time.

SaaS providers typically charge a monthly or annual license fee. The hefty cost of purchasing desktop software, setting up internal server exchanges, evaluating each workstation for hardware requirements, and performing individual installs is replaced by a more manageable recurring payment.

SaaS tools are very portable. With the proliferation of Wi-Fi Internet access, managers and executives get the functionality of their applications through wireless-enabled devices like laptops and PDAs. Think about it—minutes from now, you could be managing projects that span the globe from the comfort of your blackberry.

To read the full report, go to
www.expert-insights.com/attask.asp

task

@task is a leading provider of web 2.0 on-demand project management software. Customers include Apple, CBS, Chevron, Hanes, HBO, Hitachi, Lockheed Martin, Louis Vuitton, Macy's, McDonalds, Toyota, US House of Representatives, Walt Disney, and the Wharton School of Business. @task is browser, platform and database independent and, allows organizations to define initiatives and projects, automate processes, and distribute real-time data through a secure and easy-to-use online environment. @task provides global support allowing users to collaborate on projects in their native language. For more information visit www.attask.com or call (866) 441-0001.

Dispersed Task Management: How a Global Team Can Work

...her you're developing software, managing a
...team or manufacturing faucets we more often
...t work with a global team. For good or bad—
...e reality. Many business leaders have dispersed
...project teams around the globe and managing
...and requires the right technology to tie project
...together so they can work effectively as a team.
...can find yourself struggling with traditional
...ches to managing project teams. Traditional
...management tools lack certain key elements
...oy's environment. Project software often omits
...of the knowledge worker. While they do offer
...h scheduling features, they lack a focus on
...ation, tools, and work allocation for the many
...als dispersed about the world. Also missing,

are enabling tools that allow the team to prioritize and focus their efforts across borders and time zones.

By allowing knowledge workers common access to shared tasks and documentation, communication and productivity can be greatly improved. But to be part of a winning team, they need to be playing the same game as well.

Here are six key concepts in creating a dispersed project team management system:

1. Classify – Define and categorize task items.
2. Target – Parlay action items into specific tasks on a milestone schedule.
3. Prioritize – Rank and order task action items for all team members.
4. Collaborate – Select and direct the right tasks for

and to the right people.

5. Check Status – Monitor tasks with regard to schedule and milestone adherence and completed task actions.

6. Maintain History – There is valuable information in project history. Historical data gives way to continuous improvement.

Today's project teams need tools that can transform an overwhelming project into very specific tasks. Such technology must respect workloads, milestones, and task priority. Simply stated: knowledge workers need to know who is doing what, when, where, and how.

If the planet earth is our new playing field, project management must be turbocharged with smart technology to play the game well. Dispersed task management changes the rigor of the distributed team. For most any organization, it deserves serious consideration.

To read the full report, go to
www.expert-insights.com/alexsys.asp

ALEXSYS

Team 2

alexsyscorp.com

Rich Bianchi is the president of Alexsys Corporation, based in Stoneham, MA. Alexsys Corp. is an innovator in software solutions designed to automate the management of tasks and business processes associated with any kind of organization. Alexsys Team® 2 software is a powerful project management tool that helps organizations complete complicated projects on time and within budget by recording and managing responsibilities with due dates for tasks. It's solutions have been deployed by hundreds of organizations of all sizes around the world, including leading Fortune 500 companies in the petroleum, financial services and telecommunications industries as well as large government agencies. For more information visit www.alexsyscorp.com.

Piercing the Lazard Mystique

THE LAST TYCOONS The Secret History of Lazard Frères & Co.

By William D. Cohan; Doubleday; 741pp; \$29.95

What is it about investment banking that brings out the long knives? Internecine warfare is so prevalent in that culture that books about Wall Street houses are inevitably crowded with villains and desperately short on heroes. Remember *Greed and Glory on Wall Street*, Ken Auletta's 1986 account

of the civil war that ripped apart Lehman Brothers Kuhn Loeb? William D. Cohan's *The Last Tycoons*, an ambitious if flawed history of Lazard Frères & Co. (now Lazard Ltd.), is just such a book.

In 2005, Lazard became the last of the classic investment-banking partnerships to convert to public ownership. A midsize firm with an outsize mystique, Lazard had been a fount of profit and intrigue for the better part of a century and a half.

It could scarcely have been otherwise given Lazard's pedigree. For most of its history, the House of Lazard was actually three separate investment banks of different nationalities—American, French, and British—coexisting uneasily under the shared roof of overlapping ownership. Lazard also was the first investment bank built on advising corporate mergers and acquisitions, the most Machiavellian of high-finance specialties. Finally, it has been led by a procession of legendarily brilliant and difficult personalities, including André Meyer, Felix Rohatyn, and current CEO Bruce Wasserstein.

At 741 pages, the copiously footnoted volume aspires to be a definitive history of Lazard. The author, a former newspaper reporter who spent six years at the firm as a junior banker, is commendably thorough in his research, which includes interviews with dozens of key participants, Wasserstein prominently excepted. Even so, Cohan's sprawling volume falls well short of the standards of interpretive analysis and literary excellence set by such classic works as *Financier*, Cary Reich's 1983 biography of Meyer, and Ron Chernow's 1990 tome, *The House of Morgan*.

The Last Tycoons does benefit from well-drawn profiles of many of Lazard's leading characters, particularly Michel David-Weill, the clever, imperious French billionaire whose family controlled the firm for four generations and who presided over it himself from 1977 to 2005. Both David-Weill, Lazard's last emperor, and Rohatyn, the founding father

of M&A, emerge from these pages in all their fascinating complexity and maddening hypocrisy.

The book's other strength is its closely reported narrative of the tumultuous events of the past decade, which saw Lazard's near-collapse in David-Weill's final years and its revival under Wasserstein, who previously had made a fortune co-founding and selling Wasserstein Perella. The success of Wasserstein's ingenious, daring scheme to transform Lazard into a publicly held corporation added hugely to his net worth while reviving the foundering bank. Lazard's stock has doubled since going public at \$25 a share in the spring of 2005.

Cohan's lengthy account of David-Weill's and Wasserstein's climactic pas de deux might indeed prove definitive despite occasional lapses of analytic judgment. Cohan suggests, for example, that Wasserstein's initial \$30 million investment in Lazard was money he'd saved (and would not otherwise have had) by moving to London to avoid paying New York state and city taxes on the \$1.4 billion sale of Wasserstein Perella. Setting aside the question of Wasserstein's motive for moving to London, he was a wealthy man who could have pulled \$30 million from any of the pockets in one of his bespoke suits.

Worse, Cohan spices up what is a pretty technical saga with a lot of thinly sourced rumor mongering about the sexual misadventures of high- and low-ranking Lazard employees. He

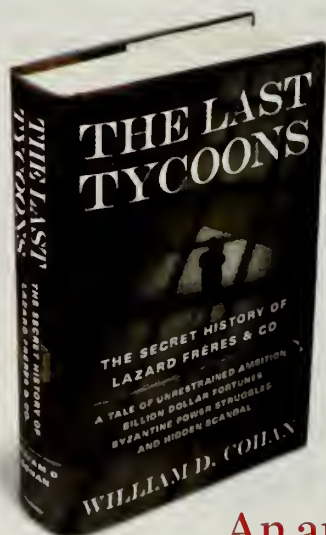
closes one particularly salacious section by noting: "These rumors persisted, even though some clearly were not true." Why smear people by printing stories known to be false?

That Cohan once worked at Lazard causes a reader to wonder whether there is score-settling mixed in with his journalism. That said, the author often puts his inside knowledge to constructive use, such as in his amusing

explication of David-Weill's passion for Cuban cigars and the social significance of cigar-smoking at the firm.

The Last Tycoons should appeal to anyone interested in the inner workings of Wall Street or Lazard, long the most idiosyncratic of investment banks. Despite the upheavals this book documents, Lazard still occupies the same basic position on the Street that it did in the 1950s and '60s—that of a compact, elite M&A specialist with a front-row seat at the deal game. ■

—By Anthony Bialek



An ambitious if flawed account of the bank's near-collapse and revival

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Improving the Customer Experience with Personalized Communications

Successful organizations continually look for ways to reach the right prospects, boost response rates and strengthen customer relationships. As competitive pressure rises, improving the customer experience is increasingly important. Reaching prospects and servicing customers through a variety of communications, including marketing materials, welcome kits, statements, and correspondence. Producing relevant, consistent and appealing communications results in a more satisfying customer experience and greater revenue opportunities. Customer Communications Management (CCM) enables the generation of highly personalized customized communications to improve the customer experience. Two of the most challenging forms

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Technology Improves Efficiency in Pharmacy/Healthcare Markets

Community and hospital pharmacies are facing numerous business challenges and efficiency issues. One of the fastest-growing trends in pharmacies is the use of letter-sized prescriptions by healthcare providers. Pharmacies are experiencing greater than 100% increases in the number of patients submitting 11" prescriptions over traditional 4"x 6" written prescriptions. While original prescriptions must be physically or electronically stored up to 7 years according to federal mandates, traditional desktop document scanners present problems. Roll-fed or flat-bed document scanners are unreliable and unable to withstand the rigors of processing hundreds of documents daily per hour. High-speed scanners are expensive and too

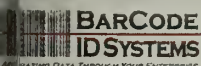
large for limited countertop spaces. As the average number of prescriptions purchased in the United States has topped 3.6 billion per year, pharmacies are often overextended with processing times and storage capacity limitations.

Recent advances in imaging technology can allow pharmacies to improve their prescription processing methodology and reduce the time spent scanning prescriptions and patient identification. New imaging devices can reduce the scan time of letter-sized prescriptions by 900%, from as much as 1 minute per scan, down to <5 seconds. With average pharmacies processing 1340 prescriptions per week, the labor efficiencies gained can be remarkable—up to 15 hours per week.

Image compression technologies associated with the new devices also produce dramatic disk space savings, replacing file sizes of 1-2Mb from traditional scanners with files as small as 48Kb.

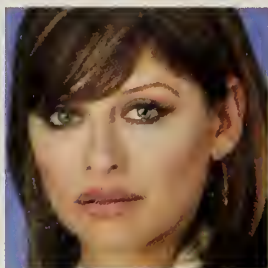
While advanced imagers are ruggedly-designed to manage high-volume prescription imaging without downtime, they also scan and process bar code data. Pharmacies can scan curved medication bottles, prescription numbers and other retail purchases without adding additional devices to crowded countertop space. This technology is applicable in virtually any industry requiring fast capture of high-resolution document images with bar code scanning and signature capture. In healthcare markets, medical-, hospital- and physician-groups can benefit greatly from imager/scanning technologies to improve performance, increase productivity and reduce or eliminate paper-driven processes.

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IdeasFaceTime

WITH MARIA BARTIROMO

Rudy on Iraq, Taxes, Mistakes



IN TWO TERMS as mayor of New York, Rudy Giuliani turned a city beset by crime and violence into one of the safest, most livable metropolises in America. And he fearlessly led New York and confronted the despair and destruction following September 11. But the turmoil of Giuliani's private life prompted many to dismiss his quest for Republican nomination for President as the effort of a man with too much baggage to be a serious candidate. Never one to put much stock in political pundits or conventional wisdom, Giuliani has soldiered on, and as of Apr. 18, early polling had him leading the GOP pack.

What would you do differently in Iraq?

I think the policy in Iraq has to be: Clear, hold, and build. As you get to a situation of considerably less violence, you have to get the Iraqis to rebuild their infrastructure, open their factories, fix their roads and schools. The statistic that worries me most about Iraq, in addition to the obvious violence that has been reduced, is its 60% unemployment, at least as of a month ago. If there's 60% unemployment in Iraq six months from now, it's going to be very hard to create stability.

When should the troops pull out?

I can't emphasize [enough] how irresponsible Congress has been. The idea of having a timetable for withdrawal, which many of the Democrats used to say they would never do...is very, very dangerous. I can't remember in the history of war when an army of a country has announced its retreat and then given the enemy a timetable of that retreat. It is dangerous for our troops, it's dangerous in terms of the way in which it will promote terrorism, and even dangerous, to some extent, for us here at home. If we do a timed withdrawal from Iraq, how is that going to affect us in dealing with Syria, Pakistan, and Afghanistan? In every one of those situations, it's going to make things much worse for us.

Do you think we need to boost the budgets for security and the war on terrorism? If so, how do we do that in the face of mushrooming costs for Social Security and Medicare?

The first thing we need is a budget-reduction program. I don't think the government has had that kind of fiscal discipline, at least in my memory, since the Reagan Administration. What I did in New York was impose budget cuts on every one of my agencies...5% to sometimes 20%. That resulted in a 20% reduction in the size of the

ment, with the exception of cops and teachers. And the
ary needs to be modernized. We've never quite made up for
peace dividend we got during the Clinton Administration.
s something I strongly opposed when it was happening. I
ght it was kind of a repeat of the mistakes made right after
d Wars I and II when we were anticipating an entirely peace-
world. The peace dividend was a very, very big mistake.

Do you support extending the 2001 and 2003 tax cuts?

port continuing the level of taxation where it is, certainly not
g it increase. I would try to look for additional tax cuts that
ulate the economy. As mayor of New York, I cut taxes and
d more money. For example, the capital gains tax is a really
t tax to cut because if you cut it the right way, you could end
ith much larger growth. I did that with the hotel occupancy
got it cut by about 30% and was collecting \$100 million
from the lower tax than the higher tax. And the death tax is
great example of what's wrong with Washington. The death
going down to 45% in 2009. In 2010, it's
to zero. Then in 2011 it goes back to 55%.
is ludicrous. Only Washington could cre-
tax incentive for death. We've got to either
nate the death tax—it's a double tax, any-
—or reduce it to something sensible.

Recently picked up Steve Forbes, who is a flat-tax advocate, as an adviser. Do you support a flat tax?

port simplifying the tax code. I think of
at tax as theoretically a very good solu-
—and probably what we should have done
we first started the income tax. These
it would be unrealistic to go all the way to
tax. But you can use it as a guide to figure
ow you're going to simplify taxes.

Economies of China and India are soaring. Should we be jealous of them, and how tough should the U.S. be on China?

should see the growing economies in India and China as
opportunities for a country that is the leader in the world in
technology, innovation, management, and administration. Every
I go, people want to learn about how America organizes its
panies, how America has been able to be so productive. We
tell that to the world. In many ways India is at least as good or
an opportunity than China. It's already a democracy. It's al-
a country with a rule of law and courts. The big problem in
a is protection of intellectual property. So we have to work on
fronts—keep China opening up its markets and at the same
try to get it to develop a more sophisticated legal system.

What about Russia? Is it an ally or an enemy?

ave to be concerned about a country that has taken big
backwards in terms of proceeding as a democracy, as a
try that respects human rights. And then we also have to
ncerned about a country that appears to be using its en-
position to get leverage in Eastern Europe and Europe.

Should Sarbanes-Oxley be changed?

ave a tendency to underregulate. Then we have scandals, and
ving wildly in the other direction. I think it's time we take a
at some of the requirements of Sarbanes-Oxley. That doesn't
we get rid of it, but we start to make it more balanced. Most
merican businesspeople are honest. We have some dishonest
but we can't overreact to that.

Why do you think you can win over Christian conservatives?

Because Republicans, however people describe them, respect
people who tell them who they are and don't pretend that
they're going to agree on everything. Ronald Reagan is kind
of my model, and his approach was: "If you're my 80% friend,
you're not my 20% enemy." I think I'll do well with conserva-
tive voters because they will see that I'm one of the most fis-
cally conservative candidates in the race. I'm the one who has
just about the strongest record on tax cuts. And I think they
will be in pretty close to total agreement with me on how to
handle homeland security and deal with terrorism. On social
issues, they're going to find that the area of disagreement is not
as great as some of my opponents have told them.

But so much has been made of your decidedly unconservative positions on gay rights, gun control, and abortion. How big a factor will those positions, your personal history, and Judith's personal history be in the campaign and Presidency?

Ultimately, the election will be about who
the American people think will be the
most effective leader. And they have every
right to examine all aspects of my public
life and my private life. Because I've had
such a long career in so many different ar-
eas—probably the most diverse of anybody
running—they can look to the success that
I've had even though I've made mistakes
and things went wrong, which I think kind
of makes me human. When I was mayor,
various things going on in my private life
did not stop me from reducing crime by
57%, reducing homicides by 67%, turning
a \$2.3 billion deficit into a multibillion-dol-
lar surplus. It didn't stop me from reducing

the welfare rolls by 660,000. Then I had to deal with the worst
attack in the history of the city, maybe the country. Sure, I've made
mistakes, both privately and publicly, but what's the balance? The
balance is that I've been able to have success. So I think they can
be pretty confident that that's what would happen as President.

You said your wife, Judith, could sit in on Cabinet meetings if she wanted to. What role would she play?

The preface to that, Maria, was a question by Barbara Walters
about what Judith would be interested in as First Lady. And her
answer was: "I'm a nurse...and what I think I would be good at
is educating people about the things they have to do to remain
healthy." So then Barbara asked me: "Would you be comfortable
with Judith sitting in on Cabinet meetings?" And I said: "I would
if it was in areas that she's interested in or in areas where she has
expertise." But she has no interest in being part of the Cabinet.

What about the critics who might ask how you are going to get things done with Congress? Does this country want another "my way or the highway" President?

I dealt with a city council that was 45 Democrats and 6 Repub-
licans. And somehow I was able to get 23 tax cuts or elimina-
tions...and that turned the city around. I've been in the federal
government more than city government. I was the third-ranking
official in the Justice Dept. I worked with Congress in the Ford
and Reagan Administrations. I ran as a mayor by saying—and
I borrowed this from [Mayor Fiorello] LaGuardia—there is no
Republican or Democratic way to pick up the garbage. ■

Maria Bartiromo is the anchor of CNBC's Closing Bell



Ideas **The Welch Way**

BY JACK AND SUZY WELCH

When to Talk, When to Balk

In an environment that is both increasingly competitive and unforgiving toward secretive organizations, how do leaders identify the level of transparency that balances good public relations and strategic privacy?

—Nicolas Rodriguez, Lima, Peru

When it comes to transparency, leaders don't need to pull off a balancing act as much as they need to stick to four rules. Two are easy, one should be easy but constantly gets screwed up, and the fourth is just plain hard. No picking and choosing, though. In today's "unforgiving" environment, to use your apt term, you need to follow them all.

The first rule is that when it comes to communicating financial information to investors, analysts, and the media, public companies can't be transparent enough. Every piece of data disclosed increases the market's insight and, ultimately, builds trust. That dynamic is a no-brainer, and despite the carping of shareholder activists, most companies get it right. The second rule is that when it comes to gaining marketplace advantage, you can't be too secretive. With a breakthrough in the works or a bold acquisition under consideration, managers should fight to keep such information confidential. Strategic surprise is one of the great weapons of business "warfare."

The third rule, where things too often go awry, concerns communicating with employees about "Oh-God-No!" kinds of changes, such as plant closings or layoffs. Obviously, companies should never let employees be the last to know the details of such life-altering events. Indeed, they should be the first. That's the rule. But somehow, the typical scenario plays out like this: A company posts disappointing results and, to mollify analysts, quickly announces job cuts with big, precise-sounding numbers. The news not only takes employees by surprise but also usually leaves them twisting in the wind for weeks (or even months) before managers figure out exactly what they're going to do and to whom. That is just awful leadership. The same happens with mergers, especially those that come with pronouncements about massive cost savings from the combination. While executives sit around pondering every conceivable option, Joe in San Jose and Mary in Baltimore are dying inside—a condition not exactly conducive to, say,

innovation, teamwork, or customer service, not to mention rapid productivity gains.

The fourth rule—the plain hard one—also gets broken all the time. The reason: It requires people to do something unnatural, which is to go public when they most want to hide in a cave. You've seen it. Bad news about your company hits the paper and suddenly grim executives are huddled in conference rooms, only to emerge with evasive statements that imply the problem is small and fully contained. What a pointless exercise. Just about every business crisis involves more people, money, and damage than appears at first, and there are no secrets in the world. That's why the only meaningful strategy in a crisis is full-bore openness, with all energies focused on fixing what went wrong.

Now, we don't mean to oversimplify something that is an important business issue, but managers needn't over-brain this one. Transparency has its time, and with just one exception, the answer is largely now.

What decision model can be used to launch a technology at the right moment?

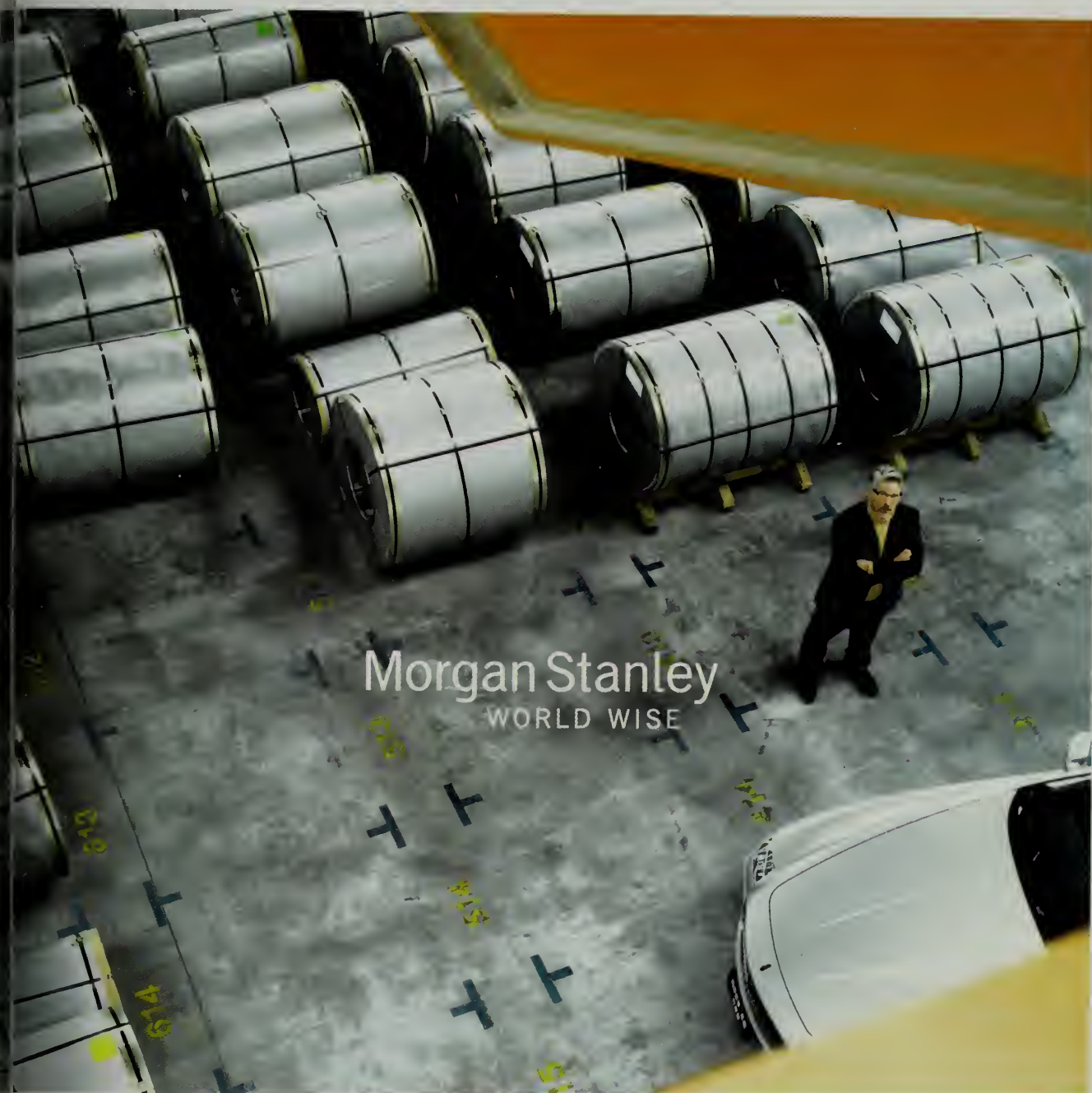
—Kees Moolenaar, Rotterdam, The Netherlands

You must be referring to the famous "Someone is shaking me by the collar, and even though I don't know every piece of market data I wish I did, my gut says it's probably O.K. to launch the thing at this point" model. Admittedly not a very precise model, but it's the only one we know that works.

We're just saying there's very little science to timing a tech launch. Sure, you have to conduct research to determine if there's a hole in the market that your product fills better than anyone else's. But you will never know exactly how the market will respond, nor will you ever be 100% certain about the viability of your technology. And forget discounted-rate-of-return analyses. With a new technology, those numbers fall somewhere between guessing and wishful thinking.

Which is why your decision "model" comes down to two factors: a positive gut feeling drawn from enough data, and a person in your organization who's wildly excited to lead the charge. Don't bet on one or the other. Only bet on both. And even then, understand that timing a new-technology launch basically comes down to a white-knuckled leap of faith. And courage is something no model can quantify. ■

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